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**In the Supreme Court**

OF THE  
**United States**

OCTOBER TERM, 1940

No. 589

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CHARLES ELMORE GROPLEY  
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A. A. NEWHOUSE, J. R. MASON and  
MARY E. MORRIS,

*Petitioners,*

vs.

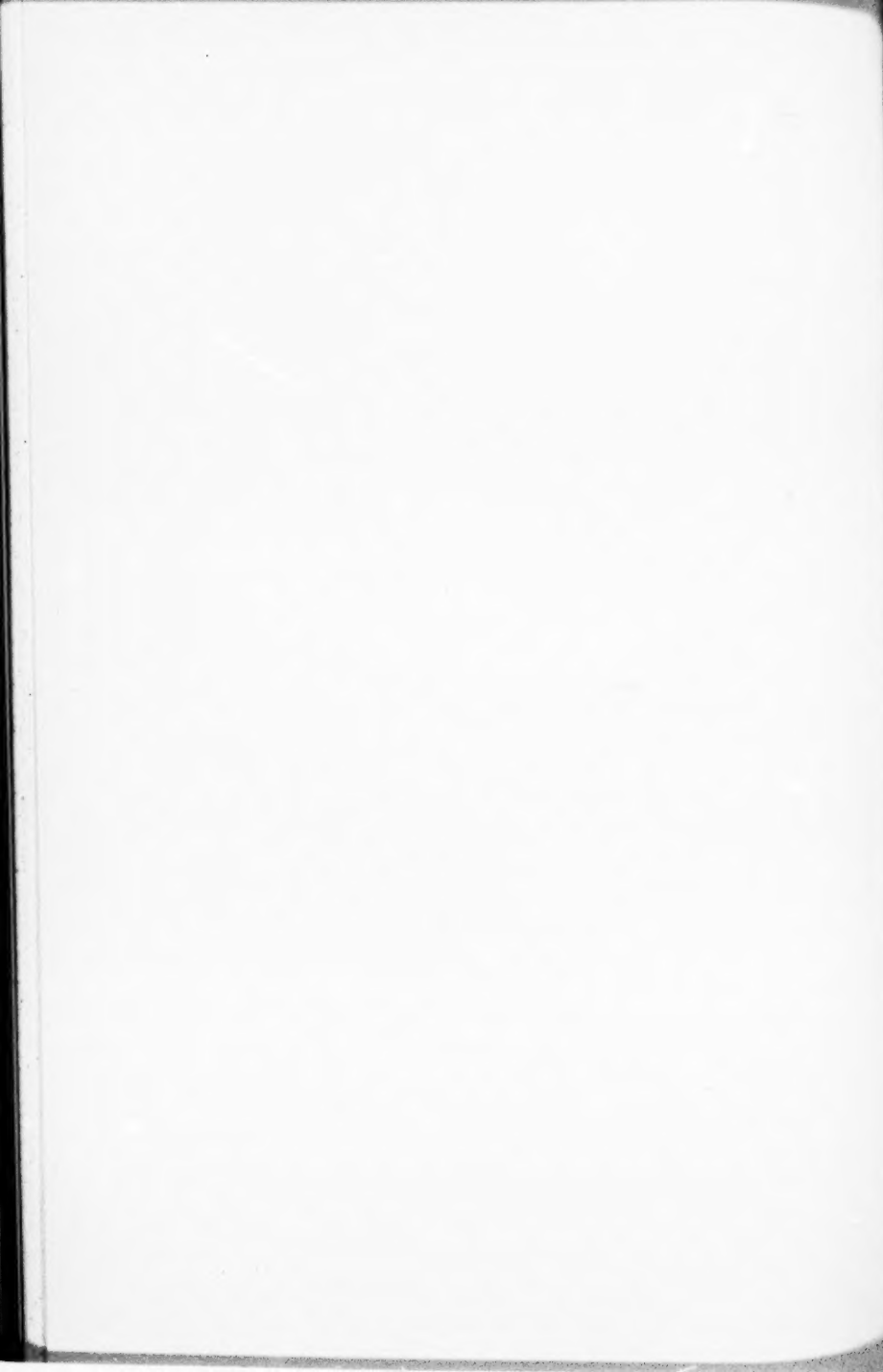
CORCORAN IRRIGATION DISTRICT,

*Respondent.*

**PETITION FOR WRIT OF CERTIORARI  
to the United States Circuit Court of Appeals  
for the Ninth Circuit  
and  
BRIEF IN SUPPORT THEREOF.**

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<p>The words "fair and equitable" in Section 83 of the Bankruptcy Act have been misconstrued. The District's plan was not "fair and equitable" as it deprived the bondholders of Corcoran Irrigation District of approximately nine-tenths of the security behind their bonds, while California law makes bonds legally perfect if the equity in the security is but 40%. The decision violates the doctrine of the Los Angeles Lumber Products Company case.</p>	
<p>The evidence showed that in the five year period of default, the District did by levying water tolls and a small tax rate not only contribute funds to buy up its bonds under its plan (as stated in the opinion of the court of appeals) but it also increased its capital surplus equal to what would meet its entire bond delinquency of nearly \$300,000.00 .....</p>	
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A. A. NEWHOUSE, J. R. MASON and  
MARY E. MORRIS,

*Petitioners,*

VS.

CORCORAN IRRIGATION DISTRICT,

*Respondent.*

## PETITION FOR WRIT OF CERTIORARI to the United States Circuit Court of Appeals for the Ninth Circuit.

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*To the Honorable Charles Evans Hughes, Chief  
Justice of the United States, and to the Associate  
Justices of the Supreme Court of the United  
States:*

Come now the petitioners above named and respectfully pray that a writ of certiorari issue to review the judgment entered September 5, 1940 against them by the United States Circuit Court of Appeals for the Ninth Circuit. (R. 366, 367.) The judgment affirmed

an interlocutory decree of the United States District Court for the Southern District of California, Southern Division, dated May 22, 1939. (R. 85 to 95.) The interlocutory decree confirmed a plan of composition of the bonded indebtedness of respondent, Corcoran Irrigation District.

Petition for rehearing was denied by the Circuit Court of Appeals on October 15, 1940. (R. 367, 368.)

Petitioners hold \$44,000.00 in bonds of Corcoran Irrigation District with all interest coupons representing interest accruing after July 1, 1933. (The claims, R. 53, 55 and 47.) (Stipulation, R. 258.) The bonds are affected by the plan of composition.

The district was formed under California law.

Every point relied on was pleaded. (R. 16 to 32.)

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#### **SUMMARY STATEMENT OF THE CASE.**

The composition petition was filed by the irrigation district on September 12, 1938 (R. 2 to 15) under Section 83 of the Bankruptcy Act, approved August 16, 1937.

11 U. S. C. A., Sec. 401;

50 Stats. at L. 653, Chap. 657.

As shown by the petition (R. 2 to 15), the bonded debt of the district was \$733,000.00 with interest 6% per annum from July 1, 1933. The plan required acceptance of 75% of the principal of each bond of the district and the interest due thereon and that the cash should be provided in part by the district and



in part by a loan of \$484,500.00 from the Reconstruction Finance Corporation, and that the R.F.C. would receive new bonds of the district for its advances. (See undenied allegations of Petition, including Exhibit A, R. 2 to 15.)

The district contains 51,600 acres. (R. 121-124.) We ask the court to bear in mind that the per acre bonded debt of Corcoran Irrigation District was low; *also that the landowners had their own deep well systems which improvement alone had cost more than the bond burden which it is now proposed shall be left on this district.*

When it is noted that the district had in its treasury when the petition was filed about \$150,000.00 above what was carried as a rule for future needs and that that money could have been held as surplus if not applied on the \$484,500.00, the court will see what the per acre debt of this district is to be as a result of this settlement. Disregarding the cash the bond debt is to be cut to \$9.389 an acre, while the market value of the land at depression valuation is \$87.50 an acre. The new debt bears interest at 4%—an annual interest charge of a little less than 38¢ an acre.

The case presents two questions of general importance: First, it is necessary for the court to determine the meaning of the requirement in Section 83(e) of the Bankruptcy Act that a plan of composition shall be "fair and equitable"; whether it means one thing in Section 77B and something vastly different in Section 83(e). Petitioners contend that this court ruled in *Case v. Los Angeles Products Co.*, 308 U. S. 106, 60 S. Ct. 1, 84 L. ed. ...., that the words

“fair and equitable” contained in Section 77B came into the Bankruptcy Act after having their meaning fixed in equity practice and that they prevent confirming a plan of composition which compels surrender by creditors of any substantial part of their security. They say that the words have substantially the same meaning elsewhere in the same act and that they prohibit composition which requires surrender of about nine-tenths of the security for irrigation district bonds. Secondly, the court must determine whether Section 83 is not unconstitutional in its application, when the plan confirmed by the court scales down the bonded debt of an irrigation district (one of the taxing agencies named in Sections 81 to 83 of the act) without impairing the burden on the land of the bonds of an overlapping school district (another taxing agency named in Sections 81 to 83) in the event of the law of the State makes the tax liens of the two agencies equal. Further is not the act unconstitutional in its application if the plan requires reduction of the bonded indebtedness because of the existence of private mortgages on the district's lands? We contend that both the 5th amendment and the bankruptcy clause are violated.

There are other vital points requiring this court's consideration but the foregoing points show the grave injustice of this case.

As will appear from evidence (which is brief and wholly uncontradicted) the plan reduced the bonded indebtedness of respondent Corcoran Irrigation District to about one-tenth the value of the security behind the bonds. As we shall show the law of California

makes bonds of an irrigation district perfect investment for savings banks and trusts *when the equity in the security is but 40%*. Such is the state standard of highest security. The law of California justifies a bonded debt of this district of this high type nearly six times greater than \$484,500.00.

We contend that the words "fair and equitable" prohibit in a ten-man or fifty-man or a thousand-man irrigation district, the indirect giving to the land-owners, in whose behalf composition is sought, the security placed behind irrigation district bonds. Those words prevent confiscation under the guise of bankruptcy—the taking from creditors security previously vested in them. *Those words obviously require that the plan shall call merely for delay in payment when the security is ample.* Of controlling significance is the California law for measuring security behind irrigation district bonds which shall constitute investments for savings banks and trusts.

The debt of this district was thus reduced while leaving unimpaired the liens of bonds overlapping taxing agencies, which liens were but equal to the irrigation district bond lien.

We shall point to two cases under Section 77B (which section contains the requirement that a plan shall be "fair and equitable"), in each of which a Circuit Court of Appeals held invalid a plan which took from secured creditors but fifty per cent of the value of their security.

It is perfectly obvious that the District Court did not consider this district insolvent. The opinion justi-

fies the application of Section 83 to a case of inability to meet debts as they mature. (R. 59.) Nor is there the slightest suggestion in the opinion of the Circuit Court of Appeals that this district was truly insolvent but in effect that opinion is that we have no right to apply the requirement of "fair and equitable" because the district is not a private corporation. (R. 364.)

But we are entitled to invoke our right to promised security as against any argument that the landowners may make enforcement of security difficult. Through the district, the landowners are in a court having equitable powers and which has through the use of the words "fair and equitable", been given power to protect. We are no longer in a state court where we can be met with a contention commonly made that mandamus is a discretionary remedy and the writ not one of absolute right.

The Irrigation District Act of California has for years provided for refunding bonds, for delay when the immediate debt burden is too great. In fact the bonds to be taken by the R.F.C. are refunding bonds and all that a debtor is entitled to who needs but delay is delay.

We concede that the combination of low prices following 1929, the maturing of principal on the bonds of this district and the fact the district was making various capital investments caused the district to default on its bonds. But that did not prove this district was insolvent or entitled to avoid paying its bonds. Extension of time is common to compositions.

The trial court itself suggested that this case should not be closed without evidence as to the value of the land which secured these bonds. We, the petitioners, provided that evidence and it is not contradicted.

The recurring annual tax liens which secure an irrigation district bond are no more changeable than are the provisions of mortgage security.

*Shouse v. Quinley*, 3 Cal. (2d) 357, 37 Pac. (2d) 189, 45 Pac. (2d) 701.

The law reads as to payments on bonds:

“\* \* \* and all the land within the district shall be and remain liable to be assessed for such payments as herein provided.”

Sec. 33, Cal. Stats. 1917, p. 764.

(Herein we shall refer to the sections of the California Irrigation District as amended. The entire act is set out as Act 3854 in

*Deering's General Laws of California*, Vol. I, p. 1792, edition of 1937.)

Note the following late opinion:

“In our opinion, the statute was intended to secure the bonds by the proceeds of the land in the district. It is true that the bonds themselves are not a lien on the land. But the assessment is a lien (sec. 40), and the district is required to collect the assessment or sell the land. Land coming into other private ownership is again liable for assessments (sec. 33), and land in possession of the district should, if possible, be sold again, so that it may produce the required revenue.”

*Provident Land Corp. v. Zumwalt*, 12 Cal. (2d) 365, at p. 374.

In points 5 to 8 the Supreme Court of California ruled in the last case that land taken by the district at tax sale must, while held for resale, be used to provide funds to pay the district's bonds, although part of the income could be used for operating expenses.

In Point 8 in the following case, it is stated as to the land:

"It can never be permanently released from the obligation of the bonds until they are paid."

*Provident Land Corp. v. Zumwalt*, 12 Cal. (2d) 365 at p. 378, 85 Pac. (2d) 1116.

So a plan should not be confirmed without regard to this security.

Section 83 refers to "taxing agencies". They are all agencies of the identical sovereign performing one or more public functions. It may well be said that a state has the right at any time to make its tax laws more effective. A court hardly wants the agent before it with a tin cup in one hand and a club in the other. And it hardly appeals to a high sense of justice to make the creditors one of these agencies bear all the loss when the areas of the two overlap.

The bonds are general obligations—not limited as in case of improvement assessment bonds.

*Farwell v. San Jacinto, etc. Irr. Dist.*, 49 Cal. App. 167, 192 Pac. 1034;

*Bates v. McHenry*, 123 Cal. App. 123, 10 Pac. (2d) 1038.

What in all fairness did those landowners tell the bondholders who gave them the money to improve

their land? Obviously that the highest lien known to the law would secure the bonds.

The impelling force of the *Los Angeles Lumber Products Co.* case is its recognition that bankruptcy is not a scheme for passing security vested in a creditor back to a debtor. It brings composition law with the ruling that this great bankruptcy power is subject to the 5th amendment and does not permit taking the creditor's security.

*Louisville Joint Stock Land Co. v. Radford*,  
295 U. S. 555, 79 L. ed. 1593.

There was no intent to abandon the latter case in the following case. The court merely held, in effect, that bankruptcy permitted reasonable adjustment of the rights of a secured creditor and was broader than police power—not that the debtor must be rehabilitated by a gift to him of the security for his debt. The very conclusion of the last named case which upheld the modified Frazier-Lemke Act (Section 75(f)) is:

“For the reasons stated we are of the opinion that the provisions of subsection (s) make no unreasonable modification of the mortgagee's rights and hence are valid.”

*Wright v. Mountain Trust Bank*, 300 U. S. 440,  
81 L. ed. 736.

To be fair and equitable and for the best interests of the creditors, the plan presented must not confiscate. Congress put that barrier in the law.

“Accordingly the fact that the vast majority of the security holders have approved the plan

is not the test of whether the plan is a fair and equitable one.”

*Case v. Los Angeles Lumber Products Co.*, 308 U. S. 106, at p. 114, 60 S. Ct. 1, 84 L. ed. ....

“The words ‘fair and equitable’ as used in sec. 77B(f) are words of art which prior to the advent of sec. 77B had acquired a fixed meaning through judicial interpretations in the field of equity receivership reorganizations.”

*Id.* p. 115.

The court referred to the *Boyd* case.

One part of the bankruptcy act is to be treated as in harmony with the balance of it.

“As a general rule where the legislation dealing with a particular subject consists of a system of related general provisions indicative of a settled policy, new enactments of a fragmentary nature on that subject are to be taken as intended to fit into the existing system and to be carried into effect conformably to it, excepting as a different purpose is plainly shown.”

*United States v. Jefferson Elec. Mfg. Co.*, 291 U. S. 386, 396, 78 L. ed. 859.

“It is obvious therefore that in order to carry into execution the intention of the legislative department of the government these various laws on the same subject matter must be taken together and construed in connection with each other.”

*Converse v. United States*, 21 How. 463, 16 L. ed. 192.



Like terms in related statutes are presumed to have the same meaning.

*Kilgore v. Swindle*, 219 Ala. 378, 122 So. 333.

The *Boyd* case involved reorganizing a great railroad—a matter of grave difficulty. Neither is foreclosure of a railroad as simple as selling assets of an ordinary corporation. The power to fix an upset price afforded some protection. Section 77B was designed to improve the equitable remedy, to save more for creditors. The opinion of the Circuit Court of Appeals correctly refers to the fact that we are not dealing with a private debtor. That is correct. But it is also correct that we are dealing with a bankruptcy law which for all practical purposes treats the group owning the vast or petty area in an irrigation district as a corporate entity capable of bankruptcy (*Chicot Drainage District v. Baxter State Bank*, 308 U. S. 371, 84 L. ed. ....) and it is but common honesty to hold that Section 83 was not intended to be and could not have been made to be a shield for destroying security. The same purpose runs through Section 77, the railroad reorganization act; Section 77B, and Section 83. The possibility that the debtor's affairs are so complicated that the remedies at law or in equity present difficulties is absolutely no defense when the debtor seeks relief in a court of equitable powers created for the very purpose of avoiding the loss that would result from an ordinary remedy. It is of course settled that a court of bankruptcy deals equitably with every situation not covered by a bankruptcy provision. And here we have thrust into the

very act the words which say to the defaulting land-owners: You must not claim relief and excuse a low offer by the trouble you could cause in enforcing security you promised. The state is virtually acting here through a "taxing agency". (Section 81.) It has added its consent. (*U. S. v. Bekins*, 304 U. S. 27, 82 L. ed. 1137.) Are we to assume the two sovereigns agreed to jurisdiction of the bankruptcy court to permit confiscation of security vested in a creditor?

The footnotes, page 120, *Los Angeles Products Co.* case explain that under Section 12, the bankrupt proposes the settlement and that the court may approve of the plan if "for the best interests of the creditors" but that Section 77B added the requirement of "fair and equitable". This court further said:

"The District Court's further finding that if the bondholders were to foreclose now they would receive substantially less than the appraised value of the assets of the debtor corporation is no support for inclusion of old stockholders in the plan. \* \* \* One of the purposes of 77B was to avoid the consequences to debtors and creditors of foreclosures, liquidations and forced sales with their drastic deflationary effects."

*Id.* p. 123.

If what has been done here is lawful, grave uncertainty attaches to bonds. The fact that farmers fail to earn in depression years would be ground for impairing the bonds in spite of the great market value of their lands.

That debt destruction was not justified here was further demonstrated by the district's own books *which showed that in the five year period of default on its bonds, 1934, 1935, 1936, 1937 and 1938 this district added to its capital surplus more than the delinquent interest coupons amounting to \$197,104.78 plus the sum of \$103,000.00 which matured on bond principal.* It levied water tolls as the law permitted and its tax rate was so reduced that tax delinquency almost disappeared. It diverted its funds into capital investment and surplus cash. The marginal lands which were tax-deeded to the district and which are of substantial value and which are producing substantial rents, could be cancelled out of assets altogether and still the district produced and diverted into capital investments and surplus cash far more than the \$197,000.00. This district, when tax delinquency was prevalent through all the rural sections of the state, went to the California District Securities Commission and obtained permission to levy a tax rate below bond service requirements. Authority was granted in accordance with Section 11 of the act fixing part of the powers of that commission. For over seven years, Section 11 of that act had been renewed at each session of the legislature. (For example, see Sec. 11, Cal. Stats. 1917, p. 491.) It is enacted as a moratorium statute. But the district, as it was empowered to do under Section 55 of the Irrigation District Act (Cal. Stats. 1911, p. 516) proceeded to levy water tolls, which, together with new taxes and some delinquent taxes provided more than what was required to meet all maturities

on its bonds. It paid off completely the money which it had borrowed to pay interest maturing on bonds prior to January 1, 1934. As stated funds were diverted into capital investments and surplus cash. That evidence also is perfectly clear and without contradiction.

The opinion of the Circuit Court of Appeals says that we complained that the district was able to raise money to invest in its own bonds. The opinion mentioned but the single fact that we pointed out—the fact that the district was carrying at face value bonds purchased and on which it had paid about  $\frac{1}{8}$  of the price. But that did not meet the argument as to what the district raised and the opinion wholly omits to mention increased capital surplus. It mentioned but a single item of the evidence, leaving it unrevealed that what the district did in fact provide, in the five years of default, was sufficient to pay interest on the bonds which interest amounted to \$197,104.78 and all or practically all the bond principal that matured and in addition the whole of the balance of a small debt that arose from earlier borrowing to make payments on the bonds. That small debt hung over from the preceding five years. Indeed in the preceding five years, the district made capital investments far in excess of any increase in indebtedness. It greatly increased its capital surplus in the preceding five years.

The Circuit Court of Appeals went further and actually justified this plan in part by our proof of the existence of private mortgages on the lands in the

district. It held this justified a smaller offer. That is error. Our proof was offered to show that Section 83 was unconstitutional in its application here, in that the bond lien, a higher lien, was being cut down to ease the burden of the landowner while leaving private mortgages unimpaired. The uncontradicted evidence in this case was that private mortgagees came forward during the depression and advanced money to meet taxes. That is, the mortgagees recognized their liens were inferior. This erroneous construction of Section 83 is alone sufficient to justify this Court's review. State law is of course against any such holding as to superiority of private mortgages and of course state law must control such a question.

A preliminary statement requires at least some additional details.

The district was organized in 1919 under the California Irrigation District Act of 1897 as amended. (Cal. Stats. 1897, p. 254.) (Petition R. 2, 3.) The district is a public political subdivision such as the Lindsay-Strathmore District, involved in *U. S. v. Bekins*, 304 U.S. 27, 58 Sup. Ct. 811, 82 L. ed. 1137. All its powers are governmental and all its property is public and it is held upon a trust, one purpose of which is to pay the bonded indebtedness of the district. And this trust attaches to tax-deeded land. See points 5 to 8 in

*Provident Land Corp. v. Zumwalt*, 12 Cal. (2d) 365, 85 Pac. (2d) 116.

The undenied allegations of the petition for composition showed: The district issued bonds in the

amount of \$760,000.00 in 1919, the year in which the district was formed; that the bonds bore interest at 6 per cent per annum payable on January 1st and July 1st, that \$733,000.00 of these bonds and interest from July 1, 1933 were unpaid when the district defaulted on its bonds; that the plan of composition required each bondholder to accept 75% of the principal of his bonds for the principal and unpaid interest and that this payment was to be made through a loan by Reconstruction Finance Corporation of \$484,500.00 which would furnish 65.791% of the original principal, while 9.209% would be provided by the district.

As the loan resolution of the R.F.C. is dated February 17, 1937 (R. 194 and 195) and as the first interest bill on an advance of \$410,468.94 figures interest from March 3, 1937 (R. 310) it is apparent that no payment was made on the plan until interest for  $3\frac{2}{3}$  years or 22% had accrued on the bonds. In fact the delayed offer was but slightly over 61% of the total of \$1220.00 due on each bond *and by the time we had our final day in court* this plan was not a 50% plan.

The district's bonds began maturing in 1931, the schedule of maturities requiring total payments annually after that date of the sum from \$52,600.00 to \$62,000.00 over a period of 20 years. (R. 299.)

In 1929, the district started borrowing to pay part of its bonds maturities. (R. 251.) The amount unpaid on loan warrants at the end of each year varied. (R. 142, 143.) In the borrowing period from 1929 to 1934, the district levied a special assessment of \$120,000.00 to buy land to provide more wells (R. 253) and

it incurred indebtedness of \$23,827.00 in the purchase of water stock in the Peoples Water Company. (R. 252.) These were capital investments. Capital investment was certainly not less than any "permanent" general indebtedness of the district represented by loan warrants. (R. 252, 253, 254.) (R. 152, 153.)

In fact the amount of the annual borrowings were being reduced when the district quit paying interest on its bonds on January 1, 1934. As of the end of each of the preceding five years they were (see R. 142):

1929 .....	\$58,666.68
1930 .....	55,166.70
1931 .....	31,459.96
1932 .....	18,673.67
1933 .....	22,925.22

The court should keep in mind that in this period of temporary loans, the district increased its capital surplus. We shall later insert page 142 of the record which shows:

At the end of 1929....	\$267,748.37,	capital surplus
At the end of 1933....	436,469.91	“ “

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Increase .....	\$171,721.54
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This took into consideration *all debts*.

This more than equalled the increase in tax certificates which on the same page are counted in assets.

Tax Certificates (R. 142)

End of 1929 .....	\$ 14,048.27
End of 1933 .....	110,620.67

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Increase .....	\$ 96,572.40
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In other words counting the tax certificates as worthless (which they are not), it is clear beyond question that in this earlier 5 year period when this district claimed that it borrowed to pay on its bonds, it was increasing surplus.

The district failed to pay coupons falling due on its bonds on January 1, 1934, representing interest from July 1, 1933. At this time, \$733,000.00 of bond principal remained unpaid (R. 4 and 142) and as mentioned, maturities of principal were occurring. Under orders of the California Districts Securities Commission, the district reduced its annual tax rate from \$3.00 to \$1.50 per \$100.00. Part of these levies were for bond service. See bottom R. 288 and following. But the district placed no more money in its bond fund and it paid nothing more on its bonds after January 1, 1934, excepting coupons paid to R.F.C. cut from the bonds taken up.

Some time after the district quit paying on its bonds and after the enactment of Section 80 of the Bankruptcy Act on May 24, 1934 it asked its bondholders to take 59.95% of principal (R. 158), for what was due on their bonds. (R. 156.) This money was to be provided solely by the R.F.C. (See form of escrow or bond deposit agreement, R. 159 to 163.) The two-thirds consent was not obtained and the district promptly adopted its present plan under which the R.F.C. was to loan to the district part of the amount necessary to increase the offer to 75% of principal and the district was to supply the rest of the funds. The form of escrow instructions which acceptors were required to sign and leave with two



bank depositories are shown. (R. 236 to 244.) The banks were authorized to deliver the bonds to the R.F.C. on receiving payment from the sources indicated—a loan from the R.F.C. and a direct payment by the district. Over two-thirds of the bonds thus passed to the R.F.C. And we earnestly ask the court to note that at this stage when this district contemplated proceeding under Section 80, *these instructions recited that the signed instructions should be filed as the bondholders consent to the plan in a proceeding to be begun under Section 80.* (R. 237, mid page.) (R. 243, 244.) But Section 80 was invalidated in the *Ashton* case. When Section 83 was enacted all this was simply ignored and it was assumed that it could be claimed that the R.F.C. became the owner of the bonds taken up under the instructions and by its loan referred to. The district pleaded in its petition (R. 2 to 14) that it had consents over the necessary 51% on filing and that the R.F.C. *as the owner of 92½% of the bonds had given the two-thirds consent to the plan required by Section 83.* Section 83 says the consenters must be owners. A pledgee is not mentioned. Judge Yankwich sanctioned and the Court of Appeals sanctioned this about face and did this in the face of the California law that declared this dealing with the R.F.C. in this manner had to be a loan. If the R.F.C. became the owner of these bonds it would be such owner had it contributed but 1%.

The procedure here was utterly different from the practice followed in other cases and first contemplated

in this case. The district paid part of the price of the bonds.

When Section 80 was invalidated in the *Ashton* case on May 25, 1936, California passed an act to provide for the condemnation of irrigation district bonds at their market value. The act stayed all remedy on the bonds while condemnation was pending. (Act of March 26, 1937, Cal. Stats. 1937, p. 92.) Every local Superior Court judge before whom this act was tested, held it was legal. The cases had to be tried in the county where the district was situated. We mention this because of the evidence that the other side offered as to market price of the bonds. We point to what happened to irrigation district bonds; to the incessant delays that drove these bonds down so low that sales occurred at between 25 cents and 50 cents on the dollar. (R. 247.) The lack of true reliance on this California statute was shown by the fact that as soon as Section 83 was added to the Bankruptcy Act all proceedings under the state act were abandoned. This district had a suit filed under this act (R. 342 and 343) and it dismissed. (R. 348.) We respectfully request that this court remember that the word "hold-out" may also apply to skilled defaulting. Note what was done here. The California Districts Securities Commission was created on the assumption that it would protect both bondholders and irrigation districts. It fixes the tax rates of irrigation districts when serious tax delinquency occurs. The R.F.C. was surprised at the way in which this district was able to make its reports. It had written to the dis-

trict—"We generally require that such funds be apportioned equitably between the Bond Fund and the General Fund". The reply which was sent to the R.F.C. read as follows (R. 287) :

"It is the opinion of Mr. Bonte, Executive Secretary of the California Districts Securities Commission and of our attorney, Mr. Chandler, that in view of the suits filed in the Superior Court by Hold-Out Bond Holders, that we should not have any money in the Bond Funds at this time."

For five years this district kept all bond fund money out of the bond fund, using that very money in the campaign to buy up bonds. (R. 143 and 321.) And as will be shown, it used it also to pay coupons presented by the R.F.C. only.

On September 12, 1938, the district filed its petition under new Section 83 (R. 2 to 15) attaching thereto the consent of the R.F.C., as Exhibit B. *But as will be shown the R.F.C. did not in this case become the owner of the bonds, did not buy them up independently.*

Petitioners here, bondholders, answered this petition pleading various defenses. (R. 16 to 46.)

The further references to the record supporting each point here relied on will be given in the brief which will follow.

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#### QUESTIONS INVOLVED AND REASONS FOR ISSUANCE OF WRIT.

The public question involved is whether bonds of a taxing agency mentioned in Section 81 may under

Section 83 of the Bankruptcy Act be threatened with impairment, although the security behind the bonds is adequate, because that agency has had difficulty in meeting maturities on its bonds and in paying for improvements which it has undertaken.

The *main* legal questions involved are:

FIRST: As construed and applied here does not Section 83 violate the 5th amendment to the Federal Constitution by taking petitioners' property without due process of law and without just compensation?

SECOND: Is Section 83 as construed and applied here within the bankruptcy power? (Art. I, Sec. 8.)

THIRD: Have the words "fair and equitable" in Section 83(e) been correctly construed and applied?

Other legal points are presented which are just and well founded. We may state the determinations which should be made by this court in the following form:

1. This court should determine (in accordance with what it did in the *Los Angeles Products Co.* case) whether a plan is "fair and equitable" under Section 83 which passes to landowners in an irrigation district whose lands were on their own vote made security for the district's bonds nine-tenths of that security. May this be done in the face of California law that a bond is practically a perfect security when the equity in the security is but 40%?

2. Is not Section 83 void in its application here, in that it throws the whole burden of reducing the land burden on the district's bondholders, leaving unimpaired the tax "liens" of overlapping districts and private mortgages.

3. As the necessary two-thirds consent to a plan can, under Section 83 be given only by bond owners and as the R.F.C. was but a pledgee of the bonds taken up because of the district's investment therein, was consent of the R.F.C. to the plan sufficient?

Does the word "owned" in Section 83 include a pledge?

4. Is not a plan discriminatory which treats creditors differently? If the R.F.C. was a bondholder was not this plan unequal and discriminatory in that the R.F.C. was to receive new bonds and 4% on its advances between the time of its advances and the time of putting the plan into effect, whereas cash only is offered to dissenters? As the district retained the consideration and paid no interest on what it and the R.F.C. did not advance while the dissenting bondholder was having his day in court, does not fairness require payment of the interest that would have been paid to the R.F.C. if the dissenter had accepted?

5. In view of the latest holdings in California as to the public character of an irrigation district, has this court jurisdiction?

None of these contentions was upheld. In fact, the fact the land was mortgaged, was by the Circuit Court of Appeals given as an excuse for the plan.

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**THIS COURT HAS JURISDICTION.**

*Judicial Code*, Section 240(a);

28 *U. S. C. A.*, Section 347(a);

*Magnum Import Co. v. Coty*, 262 U. S. 159, 43  
S. Ct. 531, 67 L. ed. 922.

The brief will follow.

WHEREFORE, petitioners respectfully pray the writ of certiorari issue out of and under the seal of this honorable court, directed to the Honorable Circuit Court of Appeals for the Ninth Circuit in San Francisco, requiring that court to certify and send to this court for its review and determination, on a day certain to be therein named, a full and complete transcript of the record and all proceedings in the case numbered 9293 on its docket and entitled "A. A. Newhouse, J. R. Mason and Mary E. Morris, Appellants, v. Corcoran Irrigation District, Appellee" and that the said decree of said court may be reversed by this honorable court and that your petitioners may have such other relief in the premises as to this honorable court may seem meet and just.

Dated, Berkeley, California,  
November 18, 1940.

A. A. NEWHOUSE,  
J. R. MASON,  
MARY E. MORRIS,

*Petitioners.*

By RALPH R. ELTSE,  
W. COBURN COOK,

*Attorneys for Petitioners.*

GEORGE CLARK,  
*Of Counsel.*

# In the Supreme Court

OF THE  
United States

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OCTOBER TERM, 1940

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No.

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A. A. NEWHOUSE, J. R. MASON and  
MARY E. MORRIS,

*Petitioners,*

VS.

CORCORAN IRRIGATION DISTRICT,

*Respondent.*

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

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## I.

### THE OPINIONS BELOW.

The opinion of the Court of Appeals for the Ninth Circuit appears in the record at R. 364. It is reported. See 114 Fed. (2d) 690. The Merced District case referred to in the decision appears in 114 Fed. (2d) 654.

The opinion of the District Court appears in the record. (R. 364 to 366.) It is reported. See 27 Fed. Supp. 322.

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(NOTE): All italics throughout the brief are ours.

## II.

### STATEMENT OF THE CASE.

We have in the petition given an outline of the case with references and we have shown the points involved. It will be clearer to make the further references under the points argued.

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## III.

### SPECIFICATIONS OF ERRORS.

As required by the rules in the preparation of the statement on appeal, statements of the points relied on were filed. These are set out on pages 352 to 357 of the record and they constitute the errors that were relied on on the appeal.

The argument which follows is presented under separate headings. Immediately following each heading are quoted the points or errors argued under the heading. Where the statement of the points was lengthy and the heading has exactly summarized the points or errors that is explained and the points are referred to by their numbers.

Points 6, 10, 11, 13 and 14 are stated and argued under Point I of this brief.

Pages 27 and 28 hereof.

Points 5, 6, 18 and 18a are stated and argued under Point II of this brief.

Page 59 hereof.

Point 7 is stated and argued under Point III of this brief.

Page 65 hereof.



Points 15 and 16 are stated and argued under Point IV of this brief.

Page 72 hereof.

Point 4 is stated and argued under Point V of this brief.

Page 74 hereof.

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## ARGUMENT.

### I.

AS CONSTRUED HERE SECTION 83 VIOLATES THE 5TH AMENDMENT AND ALSO THE BANKRUPTCY CLAUSE BY DEPRIVING PETITIONERS OF THE SECURITY FOR THEIR BONDS WITHOUT DUE PROCESS OF LAW AND WITHOUT COMPENSATION.

THE WORDS "FAIR AND EQUITABLE" IN SECTION 83 OF THE BANKRUPTCY ACT HAVE BEEN MISCONSTRUED. THE DISTRICT'S PLAN WAS NOT "FAIR AND EQUITABLE" AS IT DEPRIVED THE BONDHOLDERS OF CORCORAN IRRIGATION DISTRICT OF APPROXIMATELY NINE-TENTHS OF THE SECURITY BEHIND THEIR BONDS, WHILE CALIFORNIA LAW MAKES BONDS LEGALLY PERFECT IF THE EQUITY IN THE SECURITY IS BUT 40%. THE DECISION VIOLATES THE DOCTRINE OF THE LOS ANGELES LUMBER PRODUCTS COMPANY CASE.

THE EVIDENCE SHOWED THAT IN THE FIVE YEAR PERIOD OF DEFAULT, THE DISTRICT DID BY LEVYING WATER TOLLS AND A SMALL TAX RATE NOT ONLY CONTRIBUTE FUNDS TO BUY UP ITS BONDS UNDER ITS PLAN (AS STATED IN THE OPINION OF THE COURT OF APPEALS) BUT IT ALSO INCREASED ITS CAPITAL SURPLUS EQUAL TO WHAT WOULD MEET ITS ENTIRE BOND DELINQUENCY OF NEARLY \$300,000.00.

Points 6, 10, 11, 13 and 14 which comprise the assignments of error discussed under this heading are (R. 353, 354):

"6. The proceeding takes appellants' rights in their bonds and interferes with their vested rights without due process of law and in violation of the 5th amendment of the United States Constitution."

"10. The district's Plan is unfair in that it grants to the district an excessive reduction in its bonded indebtedness, which deduction is out of all proportion to need."

"11. The Plan proposes to divest the bondholders of their right in security which was adequate for the payment of the obligations of their bonds."

"13. The evidence fails to show any necessity for waiving or cancelling the whole or any part of the debts of the district represented by appellants' bonds. At most the district needed a postponement of time to pay."

"14. The evidence really showed that in the very period when the district claimed it was unable to meet its bond obligations it raised by taxes and water tolls sufficient to meet its bond obligations, or almost sufficient to meet its bond obligations, as they matured."

Preliminarily we have stated that the plan of the district called for a new bonded debt of \$484,500.00. (Petition, R. 10.) The final formal contract to purchase new bonds made between the district and the R.F.C. was offered in evidence. This contract referred to Sections 3 to 9 of the California Districts Securities Commission Act which provides that bonds of an irrigation district may be certified as valid investments for savings banks and trusts and even public funds if the margin of security behind the bonds is 40%. We quote from the contract:

“8. Purchase of Bonds:

None of said bonds to be purchased unless they shall have been certified as legal investments by the California Districts Securities Commission pursuant to the provisions of Sections 3 to 9, inclusive, of the California Districts Securities Commission Act,” etc.

(R. 222.)

The last paragraph of Section 4 of the Act last referred to reads:

“No bond issue of any district shall be approved for certification as provided in this act which together with any other outstanding bonds of such district including bonds authorized but not sold exceeds *sixty per centum of the aggregate value* of the water, water rights, canals, reservoirs, reservoir sites, irrigation and power works and other property owned by the district or to be acquired or constructed with the proceeds of the bonds proposed to be issued by said district, *and the reasonable value of the lands* within the boundary of the district.”

Cal. Stats. 1931, pp. 2263, 2265.

Section 5 provides for the filing of the written report of the Commission with the Controller and Section 8 provides for his certificate which shall be attached to each bond, and show that the bond is “a legal investment for all trust funds and for the funds of all insurance companies, banks, both commercial and savings, trust companies, the state school funds and any funds which may be invested in county, municipal or school district bonds, etc.”

Where a corporation defaults on its bonds and presents a plan under 77B it is approved practice for the Court to have an appraisal of the assets of a corporation. In the trial of this case Judge Yankwich obviously felt that an appraisal was necessary. The fact that tax delinquency occurred in this district was common to the tax situation in rural sections throughout the nation. The Courts know that judicially. Tax certificates were, in this district, \$14,048.21 at the end of 1929. They were \$110,620.57 at the end of 1933. (R. 142, inserted following page 46 hereof.) At the end of 1938 the tax certificates were reduced to \$29,598.26. (R. 143.) This was due in part to redemptions and due in part to the fact that tax deeds were made to the district of some of the land which was delinquent. We shall explain fully the sole significance of this tax deeded land and that the total loss represented by taking in this marginal land was comparatively small and was offset many times over by the increase in the capital surplus of the district.

The district temporarily had large tax delinquencies but large tax delinquencies were common at the same time in rural counties. Tax delinquency arises in a large measure from the fact that *the poorer lands* can not bear the full amount of the tax burden but such tax delinquency is not proof that an irrigation district's bonds are not well secured. The testimony in this particular case showed that at the very time that Corcoran Irrigation District was badly delinquent in its taxes, Kings County, in which this district was located, was also badly delinquent in its taxes. But

Kings County is not bankrupt. Mr. Drown, the only witness who testified to this district's so-called bankruptcy, stated (R. 257):

“A. The county tax rate has remained about the same. But they had big delinquencies too.”

The opinion of Judge Yankwich stressed the importance of the showing of great tax delinquency as brought out by questions which he put to the witness. (R. 256 to 257.) But this testimony is not controlling at all in determining the fairness of a plan of composition which involves sacrificing the security which is behind bonds. Delay may be the proper remedy. Judge Yankwich asked:

“The Court. Are you going to offer any direct testimony other than what is contained in the financial statements, as to land valuations and ability to bear additional taxation?”

Mr. Chandler. Except through Mr. Drown.

The Court. All right. I didn't know whether you were going to offer that, because it is customary to do that in these cases.”

(R. 248.)

The testimony had shown that the witness Drown was the secretary of the district; that he was a farmer who had owned land in the district since its formation in 1919; that he had prepared the crop reports (R. 124 to 128) which had been furnished to the California Districts Securities Commission in support of an application to levy taxes during the depression below the legal bond service rate. He was the only witness in the case aside from the engineer. The latter testified solely as to the district's water supply. Note the

testimony which the district elected to adduce from Mr. Drown (R. 255):

“Mr. Chandler. Q. Mr. Drown, you have been familiar with the market value of land in the district for some time, have you not?

A. Yes.

Q. And around the year 1929, before the depression came on, what was a fair market value?

A. Oh, a fair market value would be on the good lands around \$200.00 an acre.

Q. And do you know what amount of money could have been borrowed in that period prior to 1929?

A. Yes, they were borrowing \$100.00 an acre. I borrowed that, myself.”

Thus the district vouched for the witness.

The cross-examination first dealt with the financial statements of the district and then it dealt with the market value of the property of the district and of the lands within the district, the very items which are valued by the California Districts Securities Commission in reporting bonds for certification.

These petitioners made the witness their own for the purpose of showing depression valuation of the land of the district and the works of this district.

We quote (R. 259-263):

“A. That’s the financial statement.

Q. Financial statement, yes. Taking the last page, there is an item of 94,000 odd dollars, water stock, Peoples Ditch Company, I suppose that is?

A. Yes.

Q. Now, is that the total amount of stock in this complaint that has been purchased by the District?

A. The total amount in dollars and cents.

Q. Well, do this figure in here, 94,000, does that represent the reasonable value of that stock now?

A. Yes.

Q. And is that stock, does that stock entitle the owner to a certain interest in the water rights?

A. It does.

Q. And can that water right be transferred to any other land?

A. Oh, yes.

Mr. Cook. Now, on that same column you have another [203] item of general properties and equipment, 1,131,000 odd dollars?

A. Yes.

Q. What is that item?

A. That item consists of the canal systems, headgates, check gate, weirs, benches, siphons, equipment, real estate, all property.

Q. That includes, for example, the 4000 odd acres of land that you have taken title to?

A. Yes.

Q. Well, at any rate, all I want to know is, your view of——. That's more than the present value of those assets?

A. Oh, yes, it's more than its present actual value, that is, so far as the physical—I don't know what you would call it, physical——

Q. Condition?

A. Condition, yes. Because the headgate and check gate and weirs are all older than they were when they were put in. Some of them have been acquired relatively over the whole period of time, so that they would not all be subject to accumulated depreciation?

A. No.

Q. Would these assets be worth half as much as they are listed there?

A. I would say they would.

Q. Well, there is another item here on your list, and that is assessed value of the District. I find that on the second page it covers the assessed valuation in the last four, the last five years. I notice a drop in the assessed valuation. Is that because of lands that were taken off of the assessment roll?

A. Yes.

Q. Now, this assessed value, while presumably it is the real value, the lands are not really worth the amount of this assessed valuation, are they?

A. No, the average price over the District wouldn't be as much as that.

Q. I think you said this was based on \$100.00 an acre in most cases?

A. Yes, we assess all the land at \$100.00 an acre with the exception of about 1000 acres, which we assess at \$80.00 an acre.

Q. Would you state what the real value is as compared to this [204] assessed value?

A. You mean from a selling standpoint, from a real estate operator's standpoint?

Q. Not a forced sale, but a reasonable value.

The Court. A market value.

Mr. Cook. Reasonable market value.

The Court. The value as determined by a seller who desires or doesn't have to sell, and a buyer who desires but doesn't have to buy.

A. Well, an average over the entire District, in the selling price of the land I don't think it would average over a hundred dollars.

The Court. I didn't get the last part of the answer.



A. I said I don't think it would average over a hundred dollars an acre.

The Court. That means, of course, raw land?

A. Yes. Well, the raw land and the improved land. Take the upper end of the District from the City of Corcoran north, it is very poor. Lands right to the north there sold for twelve and a half an acre this year. And twelve and a half and twenty-five dollars an acre for land north of the District there of the same type as the land in the District.

Mr. Cook. The Judge asked a question, are you speaking of values as they are now with the improvements that are on there now? Of course, your assessment is based upon bare, raw land?

A. Yes. Bare, raw land. And these recent sales there were bare, raw land.

Q. That is, in the northern part, you say the land is poorer?

A. Yes.

Q. Well, can you make, can you state an average for the District, good and bad, and place a value as the Judge indicated in his question?

A. Well, from seventy-five to one hundred dollars an acre.

Q. Well, your answer to that last question, when you say [205] as of the present time, do you also refer to the time when the petition was filed?

A. Yes."

Right at this stage, note that the bond debt was created to supply part only of its water. We quote from Mr. Drown's testimony (R. 303):

"Q. So that practically throughout this entire area within this District of the better land you

have the public irrigation system supplemented with the auxiliary?

A. With the private irrigations."

Also (R. 256):

"Q. Can you tell us the installation cost on an average per acre of these individual pumping plants?

A. Well, depending on the size of the land they would run from \$15.00 to probably \$25.00 an acre. The deep wells cost maybe more than the shallow wells, but the shallow wells are not such good water."

Note the following from Mr. Holley's testimony (R. 108):

"The District is able to supply only a portion of the requirement of the District.

Q. Where do the farmers receive the remaining water to mature their crops?

A. From individual pumping plants.

Q. Owned by whom, Mr. Holley?

A. Owned by the individual farmers."

There are 28,000 to 30,000 acres of land now being irrigated. Call it 29,000. That times \$20 is \$580,000.00, paid privately already. That improving is behind these bonds.

Thus the witness Drown valued the assets of the district which appear in the summations of the financial statements of the district for the years 1929 to 1939 inclusive. (R. 142 and 143.) He proceeded to give the value of the tangible assets and water stock owned by the district and he then placed the present depression valuation upon the lands of this district after having

testified on his direct examination that the better lands of the district were in good times worth \$200.00 an acre. That the court may have the proper notion in regard to the complaints of some of the California Irrigation Districts as to their debt burden it may be remarked that in some of these cases *the claim is made that the bond debt is as great as the market value of the land in the district. Such was one of the items of testimony in the Imperial Irrigation District case which went before the same Court of Appeals in a proceeding begun under Section 80 and that district merely asked for extension of time and for a scale down in interest for three years.*

There are 51,600 acres of land in this district. (R. 121, 124.) Mr. Drown testified that the land of the district was to be valued at from \$75.00 to \$100.00 an acre and in our briefs we suggested that one might disregard in the main the valuations which the witness had placed upon the district's works as being valued with the land and we suggested that we should value the land at \$87.50 an acre and add to this the large amount of cash which the district had piled up in its treasury in spite of the fact it had been participating in the buying up of its bonds and making capital investments and we suggested that we add also what was invested in water stock which was as good as cash and we had:

51,600 x \$87.50 equals	\$4,525,000.00
Cash, two items, \$135,609.49	
and \$70,027.14 or a total of	205,636.63 (R. 143)
Water stock	94,937.29 (R. 143)
Total	<hr/> \$4,825,573.92

If the water stock is excluded we have a total of \$4,730,636.63.

The new bonds will equal \$484,500.00. (R. 10, 164.)

This testimony is not escapable on any theory this district was temporarily bankrupt. The per acre debt will be almost trifling in amount. We set out in our briefs what the debt per irrigable acre was upon the lands of various irrigation districts which were or which would be before the same Court of Appeals to have their bonds re-financed. We called attention to page 37 of the official 1934 report of irrigation districts to the State Department of Public Works Bulletin No. 21-F where it is shown that the debt per *irrigable* acre of land within several districts was as follows:

Banta Carbona	\$74.84
Corcoran	14.40
Merced	95.24
South San Joaquin	87.36

And we mentioned the astounding fact that Banta Carbona proposes to pay very nearly as much per bond as this district is proposing to pay. It pumps all of its water from the Sacramento River and a great part of it requires two lifts. Merced's offer is called a 50% offer. South San Joaquin is offering almost precisely what this district is offering.

In the following case the United States Supreme Court declared that the provisions requiring that the plan under Section 77B should be "fair and equitable" were "prime conditions".

*Tennessee Pub. Co. v. American Nat. Bank*, 299  
U. S. 18, 22, 81 L. ed. 13, 15.

If so they are prime in Section 83.

“There is nothing in Section 77B which authorizes a debtor to pay a secured creditor *less than half* the amount of the debt while retaining to its own use a portion of the property securing the debt. \* \* \*”

*Security First Nat. Bank v. Ridge Land & Nav. Co.*, 85 F. (2d) 557, 561, 107 A. L. R. 1240, 32 A. B. R. (U. S.) 97, cert. denied 299 U. S. 613, 81 L. ed. 452, 57 S. Ct. 315.

Speaking of Section 77B, and of a plan of composition *approved by a large majority of the creditors*, the Circuit Court of Appeals for the Second Circuit said:

“These reasons do not justify requiring the present bondholders to lose their lien to the extent of *50 per cent* and to give up equity in the property, secured by their lien, for the benefit of unsecured creditors. In *re Murel Holding Corp.*, 2 Cir. 75 F. (2d) 941; *Gerdes Corp. Reorganizations* Vol. 2, sec. 1087.”

*In re Day & Meyer, Murray & Young*, 93 F. (2d) 657, 658.

Section 80 followed the pattern of Section 77. When the following case was before it, the Circuit Court of Appeals for the 8th Circuit said the purpose of Section 77 was that:

“\* \* \* the debtor may live and the creditors will receive *more* than is obtainable upon a liquidation sale.”

*Continental Illinois Nat. Bank & T. Co. v. Chicago, R. I. & P. Ry. Co.*, 62 F. (2d) 451.

Of composition legislation the following case states:

“Viewed practically, it was legislation for the purpose of promoting for the creditors of full, *or better*, realization of their claims than would occur through immediate liquidation.”

*In re Prima Co.*, 88 F. (2d) 785, 789.

When this district quit paying, it was confronted with three things:

(a) a program of capital expenditures.

(b) the depression.

(c) bond principal maturities and as we have pointed out it borrowed to pay on its bonds. But it borrowed less than it was putting into capital investment.

It could not show it was insolvent; really did not show true bankruptcy.

The purpose of composition is to avoid settlements which limit an offer to depression valuations. As we have stated, the valuation placed on the land within the district was the valuation of the depression years. *The following cases show that this rule is unduly severe as to creditors.*

See Point 4 in opinion in following case:

*In re Gibson Hotels*, 24 Fed. Supp. 859.

See Point 5 in opinion by Judge Sanborn in the following case:

*Central States Life Ins. Co. v. Koplar*, 85 F. (2d) 181 (8th Ct.).

The following case also shows this rule:

*Central States Life Ins. Co. v. Koplar*, 85 F. (2d) 181.

The following case indicates that the rights of creditors should by virtue of the composition provisions of Section 77B be considered as having *a greater value* than what might be obtained through liquidation; that the creditors have a right to have the going value of the corporation's business taken into consideration.

*In re Dutch Woodcraft Shops*, 14 F. Supp. 467 at p. 469.

And where value is being tested by use or yield of income it is not proper to determine the value solely by yield during depression years.

*In re Georgian Hotel Corp.*, 82 F. (2d) 917, Cert. denied 298 U. S. 673, 80 L. ed. 1395.

That applies to the ex-parte crop reports made by this district to the state Securities Commission.

To hold that a district having land worth about \$87.50 an acre and having its irrigable land already improved with private water systems is entitled to have its bonded debt cut to less than \$10.00 is unreasonable. As suggested, apply the surplus cash which was piled up in this district's treasury, while it was claiming it could pay its bondholders nothing and while investing in its own bonds and the burden almost reaches the vanishing point.

The statement in the opinion of the Circuit Court of Appeals that our contention was that the district had while defaulting raised funds to help buy its own bonds is, we say respectfully, a most unfair construction of our contention and the evidence. We showed

that this district had in the five year period of its default following January 1, 1934 raised not only \$62,437.02 to buy up its own bonds, but we showed by uncontradicted and unmentioned evidence that it had placed in capital investments an amount that exceeded the whole amount due on delinquent interest coupons extending over a five year period and amounting to \$197,104.78, but that it also increased its capital surplus \$91,698.20, not counting at all the \$62,437.02, and the total of the last two items was far above the principal that matured on the district's bonds or \$103,000.00. It does not take an expert accountant to understand the evidence. It is perfectly clear and simple.

We say respectfully that we went far enough when we proved that—judged by depression valuation—the plan required throwing away about 9/10ths of the security. We had a right to stop there and to contend that the most this district needed was delay. We provided the very kind of proof used in certifying bonds as investment for savings banks and trusts.

It is not extravagant to say that if this district could on the showing made have its debt practically halved financing of irrigation districts in California ought to be at an end. All such bonds are imperiled.

In keeping with California law (Sec. 14a Cal. Stats. 1917, p. 756) the district issued financial statements annually and showed therein assets and liabilities at the end of each year segregated in the following items:

Assets: Cash; Fed. Res. Bank Escrow; Gen. Prop. & Equip.; Water Stock P. D. Co.; First



Inst. Taxes; Second Inst. Taxes; Penalties & Costs; Tax Certificates.

Liabilities: Bonds outstanding; 7% warrants outstanding; Unpaid coupons; Cont. Obligations; Bal. of assessment; Capital surplus.

Of course, comparison of Capital Surplus at the end of succeeding years tells the story as to how the district is running, if items are not omitted. It was conceded that the item of investment in the district's own bonds was omitted. *In other words the district carried the bonds in liabilities at the full face value.*

These financial statements for the years 1929 to 1939 became the third and fourth pages of Petitioner's Exhibit No. 7, the first two pages of the exhibit being the itemized cash receipts and disbursements of the district for the period. The Exhibit comprises four sheets, R. 140, 141, 142 and 143 and we shall, to save work, insert pages 142 and 143, following page 46 hereof. In so doing we shall italicize figures to which particular reference is made.

If in each year after 1933, when the district quit paying bond interest, the whole of bond debt, counting accumulated interest, is set down in liabilities and still surplus is increased, there is but one conclusion: The district has been increasing its capital in excess of its bond debt including all bond delinquency.

Note the pages of the record, R. 142 and 143, which we insert, following page 46 hereof. Start with the end of 1933 and then look at the end of 1938. We have:

1933 Capital Surplus	\$439,469.91 (R. 142)
1938 Capital Surplus	531,168.11 (R. 143)

---

Increase	\$ 91,698.20
----------	--------------

(In stating liabilities this district adopted the practice of repeating in liabilities the total unpaid on the last annual installment of taxes, thus exactly offsetting the corresponding item in assets. The entry on both sides of the account does not affect the net result. It is like giving an asset and saying it will be soon absorbed by expense.)

Looking at R. 141, containing the district's disbursements for 1937 and 1938 we have the two items spent in buying up bonds:

	<u>1937</u>	<u>1938</u>
Bondholders account re-financing	\$59,674.32	\$2,762.70

The total is \$62,437.02. It was of course proper to put in liabilities all the unpaid bonds and also all interest unpaid, but it was not correct to ignore the fact that the district had invested funds in its own bonds. That the district was rendering statements not properly qualified on this point became immediately evident on comparing the increase in "Gen. Prop. & Equipment" in the year of greatest expenditure on the bond purchase. Turn to R. 143 and we find "Gen. Prop. & Equipment" at the end of 1936 is \$1,044,538.72 and at the end of 1937 it is \$1,090,698.70 and the difference is but \$46,109.98. But when we turn to R. 141 we find that the district in 1937 put in what it called "Bondholders account Refinancing," \$59,-

674.32 and in addition spent on "Refinancing Exp.," \$4,162.53. *In other words what was spent on bonds is not in the addition to the Property account.* So it was not denied that this district was treating the bonds taken up as owned by the R. F. C. *That is what it alleged in its petition.* We shall quote from the testimony of the Secretary of the district showing that what he classed as capital investment for 1937 and 1938 consisted of improvements. But still we have the increase in Capital Surplus of \$91,698.20 after putting the bonds in liabilities at face or \$733,000.00 and all coupons in default or \$197,104.78. (R. 143, inserted.)

Thus the increase in Capital Surplus as actually given and uncorrected almost equalled the bonds matured amounting to \$103,000.00. (R. 143.) *If the R. F. C. was made the owner of the bonds taken up in part with the district's money, that does not weaken the argument as to what this district raised in the 5-year period of bond default.*

We stress that without adding the investment in bonds amounting to \$62,437.02, the district increased its surplus by \$91,698.20.

When we add the two sums, we have:

Increase in surplus	\$91,698.20
In buying a share on the bonds	62,437.02
	<hr/>
Total	\$154,135.22

Bonds maturing in the five years equalled but \$103,000.00. (See R. 143.) Keep in mind that the Circuit Court of Appeals did not note *that accumulated in-*

*terest of \$197,104.78 is in the liabilities; that all that sum and far more was raised.*

In other words, the true increase in surplus, after charging in liabilities bond coupons in the sum of \$197,104.78 (see p. 143), *exceeded the maturities on the principal.* But even if the capacity was simply to pay the carrying charges, it would be unjust to grant more than delay.

At the bottom of R. 143 and to make the picture bad, the district made an estimate of matured bonds and coupons and interest thereon. It is not a fair test. The district's funds were diverted to capital investment and surplus cash and fairness would call for saying that if the district had not preferred itself, there could have been no compounding of interest. Note the pile of cash in the upper right hand corner of R. 143. (Inserted.) It is given in two items.

And what is the showing? It is that the delinquency was \$6.88 an acre. How about the other cases which we believe will come to this court, in which this figure will be between \$30.00 and \$40.00 an acre where there was no increase in capital at all.

Pages 142 and 143 of the record follow:

FINANCL  
CORCORAN IR  
YEARS ENDI

	1929	1930
<b>ASSETS</b>		
Cash	55,579.55	58,918.4
Gen. Prop. & Equip.	996,864.41	1,002,469.4
Water Stock P. D. Co.	20,133.13	45,315.5
First Instl. Taxes	4,522.01	22,753.21
Second " "	51,773.28	70,961.93
Penalties & Costs	452.15	2,275.33
	56,747.44	95,990.4
	14,048.21	21,759.5
Tax Certificates		
	\$1,143,372.74	\$1,224,453.0

	1929	1930
<b>LIABILITIES</b>		
Bonds Outstanding	760,000.00	760,000.00
7% Warrants	58,666.68	55,166.70
Unpaid Coupons	210.00	330.00
Contract Obligations	0	0
Recording Fees	.25	0
	818,876.93	815,496.0
	56,747.44	95,990.0
Balance of Assessment	267,748.37	312,966.0
Capital Surplus		
	\$1,143,372.74	\$1,224,453.0

BOND AND I

Un-Paid Matured Bonds 1929	0	1930	0
Un-Paid Matured Coupons "	0	"	0

[illegible]

1929		1930		1931		1932		1933	
760,000.00		760,000.00		750,000.00		740,000.00		733,000.00	
58,666.68		55,166.70		31,459.96		18,673.67		22,925.22	
210.00		330.00		150.00		120.00		17,910.00	
0		0		0		17,759.66		20,259.66	
.25	818,876.93	0	815,496.70	0	781,603	1,609.96	0	776,553.33	0
									794,094.00
	56,747.44		95,990.47		65,496.60		65,137.96		55,963.48
	267,748.37		312,966.51		373,317	331,735	412,825.51		439,469.91
\$1,143,372.74		\$1,224,453.68		\$1,220,422	20,423.91		\$1,254,516.00		\$1,289,528.27

## BOND AND INTEREST DEFAULT

BOND AND INTEREST DEFAULT									
0	1930	0	1931	0	1932	0	1933	\$	3,000.00
0	"	0	"	0	"	0	"		0

FINANCIAL STATEMENTS  
CORCORAN IRRIGATION DISTRICT  
YEARS ENDING DECEMBER 31st

ASSETS	1934	1935	1936
Cash .....	36,490.73	90,757.04	142
Fed. Res. Bank Escrow .....			
Gen. Prop. & Equip. ....	999,137.18	1,010,976.34	1,044
Water Stock P. D. Co. ....	90,402.42	92,921.16	94
First Inst. Taxes .....	21,204.49	10,715.68	12,522.14
Second " " .....	29,578.79	37,031.94	48,328.12
Penalties & Costs .....	2,120.45	1,071.68	48,819.30
			1,255.22
Tax Certificates .....	\$ 128,504.88	\$ 121,437.52	122
Totals .....	\$1,307,438.94	\$1,364,911.36	\$1,465

LIABILITIES	1934	1935	1936
Bonds Outstanding .....	733,000.00	733,000.00	733,000.00
7% Warrants .....	14,544.42	2,609.29	2,609.29
Unpaid Coupons .....	45,000.00	86,490.00	128,700.00
Cont. Obligations .....	20,095.78	22,387.08	844,486.37
			8,813.70
Bal. of Assessment .....	52,903.73	48,819.30	62,
Capital Surplus .....	441,885.01	471,605.69	530,
Totals .....	\$1,307,438.94	\$1,364,911.36	\$1,465,

BOND & INTEREST DEFAULT

Unpaid Matured Bonds 1934 .....	13,000.00	1935 .....	23,000.00	1936 .....	43,
Unpaid Matured Coupons .....	12,304.78		55,204.78		97,
Unpaid Matured Bonds 1939 .....	103,000.00				
Unpaid Matured Coupons .....	197,104.78				
	44,509.58				
Total default Jan. 1, 1939 .....	344,614.36	Accrued interest on matured bonds & coupons (estimated to \$6.88 per acre over district.)			

TS

STRICT

R 31st

1936		1937		1938
142,229.07		108,215.95		135,609.49
		72,789.84		70,027.14
1,044,528.72		1,090,698.70		1,131,100.71
94,493.66		94,937.29		94,937.29
	3,931.00		2,054.83	
	31,730.25		23,683.25	
62,135.48	393.12	36,054.37	205.56	25,943.64
122,176.96		57,102.09		29,598.26
\$1,465,563.89		\$1,495,798.24		\$1,487,216.53

1936		1937		1938
	733,000.00		733,000.00	
	0		0	
	155,280.00		197,104.78	
873,122.99	5,288.22	893,568.22	0	930,104.78
62,135.48		36,054.37		25,943.64
530,305.42		530,175.65		531,168.11
\$1,465,563.89		\$1,495,798.24		\$1,487,216.53

ULT

43,000.00	1937	63,000.00	1938	83,000.00
97,204.78		138,004.78		177,604.78

: (estimated at 7%)



In our briefs we made careful references to the cash disbursement sheets R. 140 and R. 141 covering the 5 year period and we showed items in the nature of capital expenditures and then added these to the increase in cash which had piled up in the treasury and which *increase* amounted to \$175,958.68. We made an aggregate of items of \$482,329.80—items of the kind that suggest capital investments.

We now insert our schedule of those expenditures. We are not contending that all the items represent strictly a capital investment. But the slightest glance at the schedule shows what this district did with its funds while paying nothing on its bonds. (The first items of bond interest which we enter is old interest paid in full under the plan. Warrants redeemed are the loan warrants which we have referred to. At the bottom are entered interest payments to the R.F.C. in 1937 and 1938. Everything is paid as per contract excepting the part of a bond debt singled out five years before.)

## SCHEDULE MADE FROM R. 141

	1934	1935	1936	1937	1938
Contracts and Int. —	\$ 2,133.78	\$11,102.91	\$ 1,403.30	\$ 3,525.48	
Bondholders Account					
Refinancing —				59,674.32	\$ 2,672.70
Bond Interest —	16,510.07	820.05	1,007.84	16.73	
Warrants Redeemed	8,370.80	11,945.13		2,609.29	
Warrant interest —	1,376.48	686.54		420.84	
Assessments on water					
stock —	5,833.55	5,940.05	7,832.05	17,165.66	6,069.02
Refinancing expenses	2,939.78	4,181.95	4,841.85	4,162.53	1,602.58
Capital expenditures	11,649.26	10,556.34	30,395.78	22,385.65	15,013.59
Totals —	\$48,813.72	\$45,232.97	\$45,480.82	\$109,960.50	\$ 25,447.89
The total of the foregoing disbursements is					\$274,935.90
Cash on hand increased during the five-year period					
(comparing "cash", end of R. 142, with end of R. 143)					175,958.68
Total					\$450,894.58
Interest to R. F. C. (1937)					13,967.81 (R. 142)
Interest to R. F. C. (1938)					17,467.41 (R. 141)
Total					\$482,329.80

It could be urged that the assessments on the water stock owned by the company were current. They could be thrown out for all of the years except perhaps for 1937 in which year they are entirely out of line. We prepared the schedule to corroborate what is conceded in the annual financial statements. Probably not a single item excepting assessments of the water company in which the district owned stock represented "Maintenance & Operation". The first item in the schedule "Contracts and Interest" could be thrown out entirely. But we showed it related to a bill of Fairbanks-Morse for pumping machinery. (R. 291.)

Skip all debt paying and what did this district invest in this five-year period? We have:

Contracts and Interest	\$ 17,728.69
Bondholders Account, Refinancing	62,437.02
Refinancing expenses	17,728.69
Capital expenditures, entered as such	90,000.62
Increase in cash	175,958.68
<hr/>	
Total	\$363,853.70

The item of \$175,958.68 is increase in cash—arrived at by comparing the cash at the end of R. 142 with *the two items* of cash at the end of R. 143 covering a five-year period of default. This was over \$150,000.00 above what this district ever normally carried over to the ensuing year.

The court could throw out the whole schedule and consider merely the increase in cash and we would have a sum that is not very far from the delinquent bond interest shown in the financial statement as amounting to \$197,104.78.

The last five years were what Mr. Drown stated was the worst possible five years in the life of the district. The tax levies were very low but water tolls raised substantial amounts. That was a perfectly legitimate process of obtaining revenue and it is of course a conceded fact that in the five-year period annual tax delinquencies decreased greatly. (Bottom of R. 140 and 141.) We quote from the testimony of Mr. Drown:

“Q. You’ve got that cash on hand and you have been raising a great deal of cash through

these tax levies and water tolls? That's right, isn't it?

A. Yes."

(R. 323.)

"\* \* \* Now, those people that use water pay the water tolls in addition to the regular assessments.

Q. Yes, they pay the assessments.

A. That's where the people who have had the benefit of the use of the water, pay more into the District than the people who do not."

(R. 329.)

The court must remember that this district claims that it can bear a bond debt of only \$484,500.00 bearing interest at 4% per annum; that interest on this sum is but \$19,380.00 a year and that there are 57,600 acres of land in the district.

The Irrigation District Act of 1897 has always provided that the whole of general expenses may be raised by water tolls.

Sec. 55, Act of 1897, Cal. Stats. 1897, p. 273.

*Willard v. Glenn-Colusa Irr. Dist.*, 201 Cal.

726 at p. 739, 258 Pac. 959.

We have mentioned that when in the preceding five years—1929 to 1933—this district was borrowing through issuing warrants it was increasing Capital Surplus, putting more into capital than it borrowed. In fact, if we but take the first item of Capital Surplus on R. 142 and the last item on R. 143 we have:

Capital Surplus end of 1929	\$267,748.37
Capital Surplus end of 1938	531,168.11
	<hr/>
Increase	\$263,419.74
Adding investment in bonds	62,437.02
	<hr/>
Gives	\$325,856.76

This is increase in spite of putting in liabilities the whole accumulated bond interest delinquency.

We take up again the last five years—the worst in the district's history.

On further cross-examination the witness, Drown, answered (R. 322-324):

“Q. Then in this sheet you have entered for the year 1938, in the very last column on the last page, as a liability of this District \$197,104.78, and that represents unpaid coupons, doesn't it?”

A. Yes, unpaid coupons.

Q. In that figure there are not included the coupons which were paid in the settlement with the R.F.C.?

A. No. That's eliminated.” (He is referring to the fact that the R.F.C. sent in coupons equal to its interest bill after it began advancing in 1937.)

“Q. Now, isn't it a fact that after charging all of these coupons as being unpaid, and which aggregate \$197,104.78, your capital surplus increased by the sum of \$89,283.10? That's true, isn't it?” (We inadvertently referred to the end of 1934 instead of the beginning. The figure should have been \$91,698.20. See ends of R. 142 and 143.)

"A. Well, I haven't figured the arithmetic.

Q. Well, now, what I am getting at is this: According to your own books, your capital surplus has increased \$89,000. plus, notwithstanding that you have charged as unpaid the whole of the unpaid coupons that have accumulated during the period of your default. That's right, isn't it?

A. Well, they are not capital surplus.

Q. But they are charged against assets?

A. They are charged against assets.

Q. In determining your surplus?

A. Yes.

Q. You've got that cash on hand and you have been raising a great deal of cash through these tax levies and water tolls? That's right, isn't it?

A. Yes.

Q. Now, isn't it a fact that the unpaid coupons which you have entered on this sheet, when added to the increase of capital assets as shown on this sheet, practically equal every dollar that would have been paid on the old bond issue if you had met every installment of principal and interest?

A. I don't think so.

Q. Well, have you made no computation to test that?

A. No, I haven't.

Q. Now, let me ask you this: This sheet here—I'm a little bit unclear as to years, but this last page of the petitioner's exhibit number 7, does it depict your financial condition as of December 31, 1938?

A. It does.

Q. Then this means that the 4% interest obligation has been cleaned up, up to and including the January 1, 1939 payment to the R.F.C.?

A. Just a minute, now, and we'll see. Yes, we paid the R.F.C. interest \$17,467.41."

Referring to the R.F.C. interest bill for the period from January 1, 1939 to July 1, 1939, he stated (R. 324, bottom of page):

"Q. These came in early and you paid the \$17,467.00, didn't you?

A. Yes.

Q. So that the financial statement let you start off, so far as 4% of the interest is concerned, with that paid until next July 1, 1939?

A. Yes."

Mr. Drown further testified (R. 149, 150):

"These statements show that we have built up our surplus from a figure of \$439,000.00 plus in 1933 to a figure of \$531,000.00 plus.

Q. In other words, your financial condition as reflected by the financial statement in the year when the petition in this case was filed, was entirely different from what it was in the year when you went into default on the paying of your coupons?

A. Oh, yes, sure.

Q. It has decidedly improved?

A. Decidedly improved, yes.

Q. And it has continued to improve, according to these statements, since you filed the petition in this case. Is that right?

A. Yes.

Q. In other words, if one looks at your capital asset statement, general property and equipment, you find that today in 1938, you have a set-up of \$1,131,100.51. Is that correct?

A. Yes.

Q. You, in the year '37-'38, that is, counting a year represented by those two statements for '37 and '38, you put \$50,000.00 into capital investment, didn't you, approximately?

A. Yes.

Q. What was that \$50,000.00?

A. Five wells and pumping plants and improvements, meter gates and stuff of that kind."

(R. 149, 150.)

According to the letter dated December 5, 1936, sent by Hankins and Hankins, then attorneys for the district, to the R.F.C., this district paid, in the two years 1934 and 1935 on the old warrants and on the bond delinquency which it excluded from the settlement, the two items of \$28,391.13 and \$24,554.63.

(R. 282.)

Note what Messrs. Hankins and Hankins call "Betterments and Probable Additional Sources of Income":

On contract to buy water stock, they paid. . \$14,825.32  
And during the year 1936, "capital investments was increased" by new wells and  
pumping plants. . . . . 24,221.29

(R. 279.)

The affidavit of Mr. Hansen, president, and Mr. Drown, secretary, made January 29, 1927 (R. 285-6) and sent to the R.F.C., shows:

"That they are familiar with the physical condition of the project of the above District;

That all parts of said project are in good physical condition and *no replacements or repairs*



*are necessary*, other than the usual upkeep and maintenance, except as follows:

No exceptions."

(R. 285.)

And the affidavit concludes:

"District has purchased equivalent of 98/100 of a share of Peoples Ditch Stock at a cost of \$8,633.00 and drilled five (5) new wells at a cost of \$24,290.50."

(R. 285.)

It is of course obvious that the district did not, in determining its percentage of tax delinquency, take into consideration as a part of the total tax, the water tolls.

Speaking of the five years of default the witness Drown testified (R. 330):

"Q. Now let me ask you a question. You couldn't have had a worse series of years could you, than you have been having in the last five or six?

A. I don't think so."

That men do not make money on good land for a series of years is no excuse for taking it out on those who lent the money to improve the land—unless it can be shown the value is not there.

As we explained in our briefs below, there is but one conceivable argument against these figures—the possibility that tax deduced land as carried in the assets is worth less than the price at which it went to

*the district.* In judging this tax-deeded land, the court will at least consider that all districts have some tax-deeded marginal land even in comparatively good times. The law recognizes that some land in a large body will be slow paying in normal times. It requires that assessments must be levied in an irrigation district on the theory that there will be temporary delinquencies of 15%.

Sec. 60, Cal. Stats. 1919, p. 669.

Aside from the fact that all the land was considered in the valuation testimony, the evidence clearly showed this deeded land had value. It had survived years of assessing.

We refer again to certain testimony of Mr. Drown, secretary of the district.

R. 122. He states that the amount of tax-deeded land is 4701.23 acres.

R. 144-5. He explains that the fact that the percentages of delinquencies are reduced as indicated at the bottom of R. 140 and R. 141 does not mean that they have been reduced to the full extent specified because when the district takes a deed after the land has been delinquent for the permissible legal period of three years the amount assessed against that land is taken out of the amount delinquent *and added to Property*, etc.

R. 260. He states that the tax-deeded land goes into the statement of capital and hence reduces the delinquency total.

R. 147. The witness explains that the delinquent land is first represented by a tax certificate and that these at present are \$29,598.26. We next quote the bottom of page R. 264:

"In 1929 we had \$14,048.21 in tax certificates on the books. That's page 3. The total, now, is \$29,598.26. The land that we have taken title to is included in general properties and equipment. We sold about 1590 acres of land. *We sold it for delinquent taxes, penalties and costs, and 9% interest from date of sale, with the exception of two or three cases that had so much on it we sold it for \$10.00 an acre.* We still have a quantity of land. Some of it is saleable. That is, we would sell it if somebody wanted to buy it. We have calls for it occasionally. I've got a call right now for 20 acres. The land was taken in for around fifteen, eighteen, twenty dollars an acre."

(R. 147.)

Now note what he says this land was taken in at. The price was from \$15.00 to \$20.00 an acre. Call it \$17.50.

R. 122. The tax-deeded land is 4701.23 acres.

Multiplying the 4701.23 by \$17.50 we have \$82,271.53.

Now the witness claimed that this body of land began to come into the Financial Statements in 1934, and then he gave the rentals therefrom. (R. 148.) Summarizing this we have:

1934 rentals were	\$ 378.74
1935 rentals were	1134.42
1936 rentals were	1815.66

1937 rentals were	4538.80
1938 rentals were	3490.29

The fact is this land became free of all other taxes when it was deeded to the district and until it was resold.

*Anderson-Cottonwood Irr. Dist. v. Klukkert*, 13 Cal. (2d) 191, 88 Pac. (2d) 685.

So it is perfectly apparent that these tax-deeded lands do not, either in the holding or selling of the same, represent dead loss. *Cut the price one-half and the figure is less than what the district invested in its own bonds.*

We say respectfully that it was only by overlooking the evidence and overruling the rule of the *Los Angeles Products Company* case that the learned Circuit Court of Appeals upheld this case. Yet it reversed the *Fano* case. There, without discussing "fair and equitable", it held what is stated in the first syllabus of the opinion. The effort was to cut the bond debt to 62.50% of principal. We contend the same court in effect there held that disregarding the value of security for bonds is not permissible because of mere bankruptcy. We quote said first syllabus:

"An irrigation district organized under California law was not 'insolvent' in a bankruptcy sense when it filed petition under bankruptcy act on November 11, 1937, where \$15,000 deficit on accrued interest on district bonds as shown by district's financial statement of December 31, was caused by reconstruction of irrigation system and diversion of tax moneys to payment therefor and district owned debt free, except for

interest, assets which were in excellent condition and of a value which greatly exceeded amount of district's indebtedness."

*Fano v. Newport Heights Irr. Dist.*, 114 Fed. (2d) 563.

## II.

**SECTION 83 IS UNCONSTITUTIONAL IN ITS APPLICATION HERE. THE PLAN CHARGED THE WHOLE BURDEN OF ACCORDING RELIEF TO THE BONDHOLDERS ALLOWING TAXING FOR BONDS OF OVERLAPPING TAXING AGENCIES AND ALL PRIVATE MORTGAGES TO REMAIN UNREDUCED.**

Points 5 and 6 in the statement of points (R. 353) and points 18 and 18(a) (R. 355-356) are a lengthy statement in a different form of precisely what is set out in the foregoing heading.

Section 83 should not permit a political subdivision to destroy its bondholders by reducing the tax lien which secures its bonds while leaving unaffected the tax rates or liens of other political subdivisions. Section 83 is unconstitutional in its application here because it contained no provision for bringing in taxing agencies or bondholders of other taxing agencies which overlap this district. That a law may be unconstitutional in a particular case is clear.

*Nashville, C. & St. L. R. Co. v. Waters*, 294 U. S. 405, 415, 79 L. ed. 949, 955;  
*Yick Wo v. Hopkins*, 118 U. S. 356, 30 L. ed. 220, 227.

We offered an exhibit showing over-lapping bond "liens" of other taxing districts, which likewise levy

their taxes on the lands in this district on an ad valorem basis. (R. 298.)

Every acre of the district is in a bonded school district. (R. 300 at 301.) The tax liens of those districts are but on a parity with those of the irrigation district.

*LaMesa, etc., Irr. Dist. v. Hornbeck*, 216 Cal. 730, 17 Pac. (2d) 143.

Referring to Section 3787 of the Pol. Code, which at one time made county taxes superior to irrigation taxes, it is to be noted that in 1917, which was prior to the issuance of these bonds, the tax deed for state and county taxes was placed on a parity with the irrigation act deed.

“Later, and in 1917, this section was again amended so as to except not only a lien for municipal purposes *but for irrigation district purposes as well*. Later, and in 1927 (Stats. 1927, p. 1666) the section was again amended so as to specially except a lien for reclamation, protection, flood control, public utility and other district purposes. This section has been construed by our own appellate court and by the Supreme Court of at least one other state which has enacted it into their law, from which it is concluded that the legislative intent is to place all taxes, both for county, municipal and other governmental agency purposes and taxes in the form of assessments in favor of special agencies of the state *upon an equal footing before the law*. (Bolton v. Terra Bella Irr. Dist., 106 Cal. App. 313 (289 Pac. 678); State v. Board of Commrs., *supra*.)

From the above authority and upon our construction of the section we may now safely conclude that under our system of taxation *liens* in favor of county and municipal corporations and special assessments, under the authority of state agencies for public purposes, *are all on an equality.* \* \* \*"

*LaMesa etc. Irr. Dist. v. Hornbeck*, 216 Cal. 730, 736, 737, 17 Pac. (2d) 143.

School district taxes are levied in lump sums with general county taxes.

School Code, Section 4.372;

Cal. Stats. 1931, p. 2493.

Exhibit D (R. 298) shows in the right hand column the percentage of overlapping bond liens of the other political subdivisions. They are:

Kings County	\$ 1,250.00
Corcoran High School District	63,560.00
Hanford High School District	1,500.00
Corcoran Elementary District	3,400.00
Reclamation District No. 749	4,400.00
<hr/>	
Total	\$74,110.00

The plan did not consider the tax burden of these districts at all. They are agencies of the same sovereign mentioned in Section 81 of the Act. Sections 81 to 83 say: Treat the land as a debtor. But a levee district can be in an irrigation district and either can be in a reclamation district and either such district may contain the whole of or a part of a school district. What plain discrimination it is to destroy

the right of one bond against the land while leaving another bond unaffected although issued by an agency of the same sovereign for the same purpose—any public purpose.

Clearly this district's debt could have been reduced less if Section 83 permitted lowering the taxes of these other districts.

Assuming the *Bekins* case is right on the facts, it does not say the state and the federal government can use the bankruptcy power as it was used here. That case was made out by the petition and a motion to dismiss it.

The bankruptcy power does not permit discrimination. In justifying a limit upon the claim which a landlord could make in bankruptcy under Section 77B(10), the Supreme Court took pains to point out that, *because of the nature of the claim*, the possibility of re-renting at a figure higher than estimated, no true discrimination resulted. Of the remedy, it said:

“We are unable to say that that which Congress did select so *discriminates* between individual claimants to the detriment of the petitioners as to render it unconstitutional as to them.”

*Kuehner v. Irving Trust Co.*, 299 U. S. 445, 456, 81 L. ed. 340, 347.

Evidently the 5th amendment prohibits this plain discrimination. It is not within bankruptcy power.

It is shocking that Section 83 is so carelessly worded that it did not provide for treating all creditors alike. It starts out by treating the landowners within a



particular political subdivision as being debtors to the extent of the land. It then proceeds to sacrifice the interests of particular creditors having claims against the lands which claims were created by the same principal, paying utterly no attention to the fact that by cutting down the particular bond issue and tax rate involved it is indirectly discriminating in favor of other claims created by the same principal—claims that rank the same under state law. The land is treated as bankrupt and the whole loss is thrown on a few who received their bonds under a law that promised equality. The irrigation district has an assessment roll just as the county has and levies its taxes on land as does the county and as we have shown the tax liens are on a parity in California.

Be practical, says the district. How can the very purpose of fairness be accomplished when part only of the creditors are compelled to bear the entire loss.

And what a blessing for private mortgagees. Not a word in Section 83, that permits making them reduce their loans to help out the petitioning land-owners. A mere private inferior lien is simply elevated at the expense of the dissenters who are called Shylocks and made the victims of an unreasoning sacrifice. The uncontradicted oral testimony was that there were plenty of mortgages on the lands in the district and the Circuit Court of Appeals recognizes this. We quote from Mr. Drown's testimony (R. 155, 156):

“Q. \* \* \* Of course, discharging this bonded indebtedness is a very fine thing for the mortgage holder, isn't it?

A. Oh—I don't know whether it is or not. I'll tell you: Mortgage holders advance money to take up delinquent taxes.

Q. Well, that, you found, occurred, then, in this District in a substantial degree?

A. Yes.

Q. That mortgage holders were in the habit of advancing money to take care of taxes upon mortgaged land?

A. To protect their interest.

Q. Beg your pardon?

A. To protect their interest.

Q. And is that still being done within the District to some extent?

A. Yes.

Q. That is, mortgagees abstain from foreclosure because the owner is finding difficulty in carrying the load, is that right?

A. That's right. And they advance the money and charge it.

The Court. I could make additional note of the fact the ordinary mortgage in California gives the mortgagor the right to advance money on the indebtedness. All the banking mortgages so provide that if they fail to pay the taxes it shall be added to the indebtedness.

Mr. Clark. Q. You found that the mortgagee or renters were pretty anxious to put this scheme through, didn't you?

A. I never contacted any of them at all. What I figured out in that connection, Mr. Clark, was this: That the District is entitled to tack a dollar to the land when the land is delinquent three years.

Q. Yes?

A. And when we take that dollar it wipes the mortgage off the slate.

Q. Yes?

A. Those people, to protect their interest, advance the money, take up the tax and add it to the mortgage."

What of logic which says that it is fair to excuse this plan of composition because of mortgages. The Irrigation District Act told bondholders that the tax deed would transfer an absolute title.

"The deed conveys to the grantee the absolute title to the lands described, etc."

Sec. 48, Cal. Stats. 1917, p. 271.

Why uphold Section 83 where it requires impairing the bond lien without impairing other equal or inferior liens at all?

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### III.

**AS THE R.F.C. DID NOT OWN THE BONDS TAKEN UP IT COULD NOT GIVE THE TWO-THIRDS CONSENT REQUIRED BY SECTION 83(d).**

This point was made below. Point 7 reads:

"The Reconstruction Finance Corporation (called herein the R.F.C.), is not and was not an owner of any bonds of the district, or of any interest therein and it was not qualified to give the consent necessary to the enforcement of the district's plan of composition.

The R.F.C. was a mere lender of money to the district." (R. 353.)

Section 83(a) requires that the petition when filed shall show the consent of creditors.

“\* \* \* *owning* not less than 51 per centum in amount of the securities affected by the plan (excluding, however, any such securities owned, held or controlled by the petitioner).”

Under California law a pledgee does not have title to the pledged property. He has a mere lien. The pledgee's interest may be very small.

“Pledge is a deposit of personal property by way of security for the performance of another act.”

Calif. Civil Code, Sec. 2986.

“\* \* \* the *lien* of a pledge is dependent upon possession.”

Civil Code, Section 2988.

“There are only two forms of lien which under our law can be created by an assignment of personal property as security for a debt. These are: (1) a pledge; (2) a mortgage,” etc.

*Arena v. Bank of America*, 194 Cal. 195, 228 Pac. 441.

At pages 18 and 19 of the petition filed herewith we have mentioned that this district did at first plainly contemplate treating the original bondholders as the persons who would give consent. The escrow instructions given by the bondholder to the depository bank which authorized turning the bonds over to the R.F.C., stated in terms that the bondholder was to be paid in part by a *loan* from the R.F.C. to the district and in part with money provided by the district. Note the escrow agreement (R. 239):

“\* \* \* it being understood that the amount to be received by you for my account is to be de-

rived from a loan from *Reconstruction Finance Corporation*", etc. \* \* \* "and that sufficient is to be added thereto from funds on hand belonging to the district, to pay the aforesaid 75 cents on the dollar", etc.

The bank was authorized to hand the deposited bonds over to the R.F.C., which acted through the Federal Reserve Bank in San Francisco, which later collected interest. It is impossible to understand the remarks in the opinion of the trial judge that the R.F.C. became the owner of these bonds under the particular circumstances of this case. His opinion declares this. (R. 72.) Not a single one of the cases cited in the opinion of the trial judge was like this case. In the cases cited the district did not put up any money for the purchase of its bonds. In this case, the new plan was to be carried out through the use of borrowed money and the district's money. The escrow instructions specifically showed that they would constitute the written consents of the bondholder that were to be filed when the district filed its petition under *Section 80*, which law the instructions referred to.

(R. 243, R. 244, R. 237.)

Section 80 was invalidated in the *Ashton* case and this district simply assumed the turn in of these bonds constituted the R.F.C. the owner thereof after it had very plainly had them transferred to the R.F.C. as pledgee. We are not concerned with consents by bondholders who have received new bonds as mentioned in Section 83(j) (added near the end of the Chandler Act on June 22, 1938). These old

bondholders never received "new evidence of indebtedness".

52 Stat. at L. 840, Chap. 575.

Moreover, their consent is not pleaded, but the consent of the R.F.C. is pleaded. (R. 6.)

We assume the R.F.C. is not different from an ordinary person. It is not mentioned in Section 83 as being a lender to which sanctity or exception attaches.

If the mere advance of part of the price of the bonds could have made the R.F.C. the owner, then it would have been the owner if its loan had amounted to but 1% of the bonds.

The bondholders who must consent to the *filing* of the petition and who make up the 51% are owners and it certainly would be unreasonable to assume that the bondholder who joins in giving the ultimate two-thirds consent and who is mentioned in Section 83(d) is a bondholder of a different type. The latter section uses the expression:

"\* \* \* but excluding claims *owned*, held or controlled by the petitioner, etc."

The loan resolution is literally filled with provisions indicating that a loan was intended. (R. 163 to 192.) But it says (R. 178):

"All or any part of the Old Securities *acquired or held* by or on behalf of this Corporation through *any* disbursement of or from the loan authorized hereunder as well as all rights in or to such Old Securities, may be kept alive for a greater or lesser time and for any purpose the Division Chief may deem necessary."

But it also said (R. 178, 179):

“\* \* \* if the Borrower shall, before any new bonds are delivered to this Corporation pay or cause to be paid to this Corporation an amount in cash equal to the disbursements it has made to or for the benefit of the Borrower with 4% interest thereon until paid, this Corporation will thereupon surrender or cause to be surrendered the Old Securities, etc.”

One could well say that it is absolutely immaterial whether a loan was or was not intended in the taking up of these bonds because the sole contract that the irrigation district could make with the R.F.C. under which it procured funds from the R.F.C. was a loan contract. A California irrigation district has no powers excepting such as the law confers.

“Sec. 61. The board of directors of other officers of the district shall have no power to incur any debt or *liability* whatever in excess of the express provisions of this act.”

Cal. Stats. 1921, p. 1108.

It is recognized that to enable a California irrigation district to borrow money from the R.F.C. in a refunding plan it would be necessary to add to the existing law. This was accomplished by adding, in 1933, Section 11 to an act adopted in the year 1917.

Said Section 11 contains the following:

“As evidence of such *loan or loans* and the obligations of such district to repay the same to the United States or any agency thereof, any irrigation district, upon being authorized so to do as provided by section 3 of this act as here-

inafter in this section modified, may make and enter into contract or contracts with the United States or any agency thereof, as a condition or requirement to the making of *such loan or loans.*'

Cal. Stats. 1933, p. 2395.

Old Section 3 of the act of 1917, referred to in the foregoing quotation provided for elections in making certain other contracts with the R.F.C. if approved at an election.

Cal. Stats. 1917, p. 243.

Petitioner's Exhibit 15 is the resolution of the board of directors of the district calling the election and the proposition voted upon was whether new bonds would be issued as provided in the R.F.C. *loan resolution* to which we have referred.

The Constitution of the State of California prohibited the district from making a gift. The district could not use its funds in buying up bonds with a view to vesting ownership of the same in another.

"The legislature shall have no power \* \* \* to make any gift or authorize the making of any gift of any public money or thing of value to any individual, municipal or other corporation whatever"; etc.

Const. Calif. Art. IV, Sec. 31.

This restriction applies to all subordinate political bodies.

18 *Cal. Juris.*, p. 1129;

*County of Los Angeles v. Jones*, 6 Cal. (2d) 695, 704;



*People v. San Joaquin etc. Assn.*, 151 Cal. 797;  
*Johnson v. County of Sacramento*, 137 Cal. 204;  
*County of Sacramento v. Chambers*, 33 Cal.  
App. 142.

The R.F.C. regularly took its interest on its advances. Pages 307 to 313 of the record set out the interest bills and the coupons of the bonds held by the R.F.C. which were turned in. And it was testified that these coupons equal to the amount of the interest were cancelled. (R. 314.)

“Q. At the time you received this bill did you also receive the coupons mentioned on the second sheet?

A. Yes.

Q. And what was done with the coupons which were mentioned on the second sheet?

A. Cancelled.”

And yet the trial court found that the R.F.C. remained the owner of the bonds and all coupons for interest falling due after July 1, 1933. The theory of the petition is that those coupons were not cancelled.

We ask that the court shall determine whether under Section 83, a person other than an owner is qualified to give consent.

## IV.

IF THE R.F.C. BECAME THE OWNER OF THESE BONDS THIS PLAN WAS DISCRIMINATORY IN THAT IT AND NO OTHER BONDHOLDER WAS UNDER THE DISTRICT'S PLAN OFFERED NEW BONDS PLUS INTEREST AT 4%.

THE DISTRICT NEVER DEPOSITED WHAT IT OFFERED TO THESE DISSENTERS AND IT IS NOT BOUND TO PAY INTEREST TO THE R.F.C. ON WHAT THEY ARE TO RECEIVE. IT HAS NOT AS YET BORROWED THE AMOUNT. THESE DISSENTERS SHOULD BE PAID INTEREST AND NOT BE PENALIZED FOR ASKING TO BE HEARD.

This contention was covered by points 15 and 16 of the statement of points relied on. (R. 354 and 355.) They are accurately summarized in the foregoing heading.

The plan must not discriminate. (See 83(e).)

If the R F.C. was but a pledgee that makes an end of the case for there is no consent. If it owned the bonds which it took up from the depositories, then how can it under Section 83 receive a consideration different from what is to be rendered to the dissenting bondholders. Yet it is to receive interest on its advances at 4% up to the time the plan is effective and is then to receive perfect four per cent bonds for its advances.

(R. 12 and 13.)

No such offer is made to the other bondholders.

There was no evidence the offers were equal.

Section 83(e) says the plan must not discriminate unfairly in favor of any creditor.

The law cannot penalize dissenting bondholders simply because they insisted on having their day in court and this brings up the second phase of this point. Those who accepted the plan were paid off in the early part of 1937. This is shown by the interest bills rendered by the R.F.C. to which we have just been referring. (R. 307 to 313.)

We are penalized simply because we insisted on due process of law, dared to ask a hearing in court. In the meantime the consideration is retained by the district. No tax collection was required in advance and interest was not paid to the R.F.C. until it made its advances. No loan has yet occurred on account of petitioners' bonds.

If the plan had been so utterly fair that any rational human being should have accepted it the case might be different but no bankruptcy law has ever required the acceptance of the plan of composition without according a hearing to the creditor affected. In ordinary bankruptcy the law requires the offers shall be

“\* \* \* deposited in such place as shall be designated by and subject to the order of the judge.”

Sec. 12, Bankruptcy Act;

U.S.C. Title 11, Sec. 30.

And application for confirmation can not be made before the consideration is deposited. The debtor may use his credit in providing the consideration so to be deposited.

*Zaveli v. Reeves*, 227 U. S. 625, 57 L. ed. 676;

*In re Rubins*, 74 F. (2d) 432.

It is common practice to give notes in part payment of a composition.

*In re Carton*, 148 Fed. 63;

*Wiley v. Brown*, 206 Pa. 322, 55 A. 1029.

Here the debtor deposited no funds or notes and did not become obligated to the R.F.C. for a penny of interest until the R.F.C. joined in disbursing money to the accepting bondholder. (R. 10.) To the creditor who asked to be heard the plan meant one thing. To the creditor who would surrender, it meant something else, but there is no legal ground for such distinction.

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## V.

**ALL THE PROPERTY AND THE POWERS OF A CALIFORNIA IRRIGATION DISTRICT ARE GOVERNMENTAL AND HENCE SECTION 83 CANNOT APPLY.**

Point 4 read:

“The court was without jurisdiction, etc. The district is strictly a governmental agency”, etc.  
(R. 352.)

While in *U. S. v. Bekins*, 304 U. S. 27, 82 L. ed. 1137, this court upheld Section 83, it did not have before it the recent ruling that shows that all the property of an irrigation district is public and all its functions are political. It would seem impossible to put a plan into effect against such a district without interfering with state sovereignty. These districts are:

“\* \* \* agencies of the state whose functions are considered *exclusively* governmental, their property is state owned, held only for governmental purposes; etc.

*El Camino Irr. Dist. v. El Camino Land Corp.*,  
12 Cal. (2d) 375, 85 Pac. (2d) 123;

*Anderson-Cottonwood Irr. Dist. v. Klukkert*,  
13 Cal. (2d) 191, 88 Pac. (2d) 685.

Section 83 states that the court may not

“\* \* \* interfere with (a) any of the political or governmental powers of the petitioner; or any of the property or revenues of the petitioner necessary for essential governmental purposes, etc.”

It would seem reasonable to review the *Bekins* case on the basis of the last citation. It is, of course, to be mentioned that the California Supreme Court has declared there is no impediment in these rulings.

*Peoples State Bank v. Imperial Irr. Dist.*,  
..... Cal. ...., 101 Pac. (2d) 466.

But the question is one for this court. We respectfully contend that it is contradiction in terms to say that determining under the bankruptcy power that this plan shall be enforced is not an interference with the public fiscal affairs and property of the state.

**CONCLUSION.**

This court should determine:

1. The question as to whether when an irrigation district appeals to a court under Section 83 to have confirmed a plan of composition of bonded indebtedness (which in all honesty is on behalf of landowners) the court may deprive the bondholders of nearly nine-tenths of the security behind their bonds when local law makes such bond security practically perfect if there is a 40% margin. The question as to whether the 5th amendment is violated.

2. The meaning of "fair and equitable" in Section 83.

3. Whether Section 83 requires a less offer because the land is mortgaged.

4. Whether in its application here Section 83 is constitutional.

5. Whether a pledgee of the bonds can give the consent required by Section 83.

6. Whether a plan discriminates that offers one thing to one creditor and something else to another creditor; whether interest should be paid on this district's offer.

7. Whether the bankruptcy court had jurisdiction.

The merit of our cause and the questions of statutory construction involved justify our appeal for a review.

Dated, Berkeley, California,  
November 18, 1940.

Respectfully submitted,

RALPH R. ELTSE,

W. COBURN COOK,

*Attorneys for Petitioners.*

GEORGE CLARK,  
*Of Counsel.*

*Due service and receipt of a copy of the within is hereby admitted*

*this \_\_\_\_\_ day of November, 1940.*

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*Attorneys for Respondent.*



# In the Supreme Court

OF THE  
United States

OCTOBER TERM, 1940

No. 589

Office - Supreme Court, U. S.

FILED

DEC 16 1940

CHARLES ELMORE CROPLEY  
CLERK

A. A. NEWHOUSE, J. R. MASON and  
MARY E. MORRIS,

*Petitioners,*

vs.

CORCORAN IRRIGATION DISTRICT,

*Respondent.*

RESPONDENT'S REPLY TO  
PETITION FOR WRIT OF CERTIORARI  
to the United States Circuit Court of Appeals  
for the Ninth Circuit.

F. G. ATHEARN,  
MILTON T. FARMER,

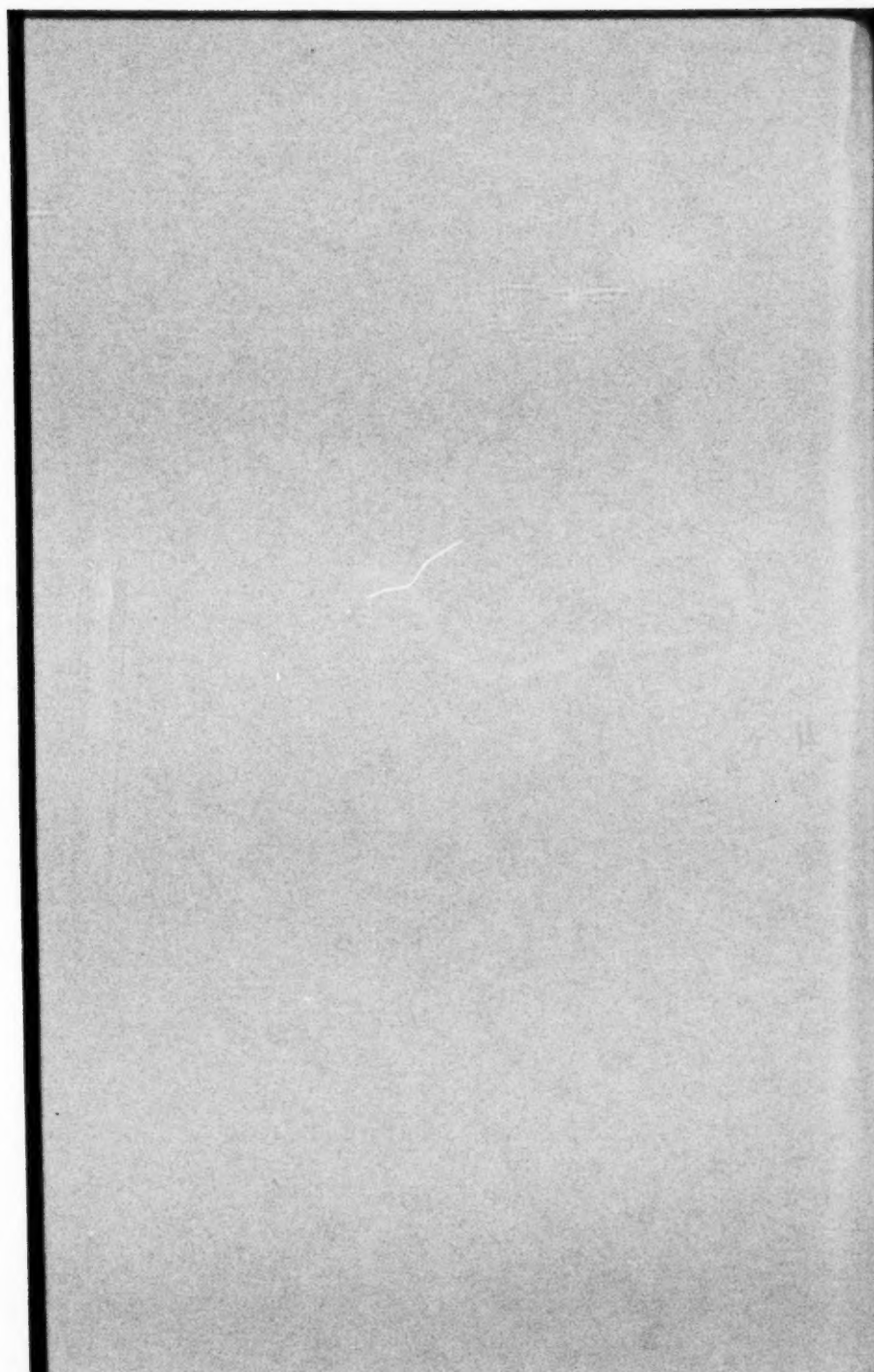
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A. A. NEWHOUSE, J. R. MASON and  
MARY E. MORRIS,

*Petitioners,*

VS.

CORCORAN IRRIGATION DISTRICT,

*Respondent.*

**RESPONDENT'S REPLY TO  
PETITION FOR WRIT OF CERTIORARI  
to the United States Circuit Court of Appeals  
for the Ninth Circuit.**

*To the Honorable Charles Evans Hughes, Chief Justice  
of the United States, and to the Associate Justices  
of the Supreme Court of the United States:*

Corcoran Irrigation District herewith replies to the petition for writ of certiorari in the above entitled matter, and prays that said petition be denied.

In its opinion herein the court below referred to its decision in *West Coast Life Insurance Company v. Merced Irrigation District* (114 F. (2d) 563) for its discussion of the principal legal points involved herein. A petition for writ of certiorari has been filed in that case. We respectfully suggest that the petition herein be considered at the same time as the petition therein.

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### STATEMENT OF THE CASE.

The facts of the case are so admirably stated in the opinion of the trial judge that we shall not burden the Court with a restatement herein. (R. 59-64.)

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### ARGUMENT.

- I. THE DECISION HEREIN DOES NOT VIOLATE THE DOCTRINE OF THE LOS ANGELES LUMBER PRODUCTS COMPANY CASE. THE EVIDENCE CLEARLY SHOWS THAT THE DISTRICT WAS UNABLE TO MEET ITS DEBTS AS THEY FELL DUE AND THAT THE PLAN PROPOSED IS FAIR AND EQUITABLE. (Pet. Br. p. 27.)
1. The court below carefully observed the principles established in the Los Angeles Lumber Products Company case.

The *Los Angeles Lumber Products Company* case (308 U.S. 106), so strongly relied upon by petitioners, seems to hold (a) that consent of creditors exceeding the statutory requirements is not evidence that the plan is "fair or equitable" in a reorganization proceeding under 77B, and (b) as a matter of law the plan is not "fair or equitable" if stockholders in an insolvent corporation having liabilities in excess of its

assets are allowed to participate before the full value of the property is first applied to the claims of bondholders.

The opinion of the court below herein adopts the opinion of the trial court with the following condition only (R. 364, 365):

“We withhold from our approval all of those remarks found in said opinion which intimate that the acceptance of the plan by the holders of a large percentage of the principal amount of the bonds should have any influence in determining the fairness of the plan.”

Other than in its statement of facts, there are but two sentences only in the opinion of the trial court in which reference is made to “the acceptance of the plan by the holders of a large percentage of the principal amount of the bonds.” (The first beginning in last line of R. 74, and the second beginning in second line of R. 77.) Each sentence may be stricken without in any way impairing the force and logic of the opinion.

The condition was undoubtedly imposed by the court below for the very purpose of safeguarding its own opinion from any criticism of asserted conflict with the doctrine of the *Los Angeles Lumber Products Company* case. That case dealt with a reorganization proceeding under 77B, and seems to recognize that “composition” may be different from “reorganization”. (Footnote 14.) It is unnecessary for us to press the distinction herein, as the court below in its opinion places no weight upon the fact that R. F. C. holds 92.6% of all outstanding bonds in this case.

The actual fairness of the plan is hereinafter considered under appropriate headings, it being essential, in this connection, to realize that we are here concerned with a taxing agency, not a private corporation.

2. There is a clear distinction in "composition" cases between the word, "insolvency", and the phrase, "inability to pay debts as they mature."

Throughout their discussion of the first subdivision of their argument, petitioners fail to recognize that they are here dealing with a *taxing agency*. The cases cited by them deal with the ordinary business enterprise. This Court knows that an irrigation system, no matter what it costs and no matter what the so-called "market value" of the lands irrigated by it may be, has no value separate from the *earning capacity* of such lands. Unless the farmers can be kept on the land and assessments kept within the ability to pay, default is inevitable.

Under the provisions of the Act (11 U. S. C. A. 403 [a]), either *insolvency* or *inability to pay its debts as they mature* gives the Court jurisdiction to entertain a plan of composition. This point is so ably discussed in the opinion of the trial court (R. 65-70) that we need not amplify it here. The court therein cites and quotes from the leading case dealing with railroad reorganizations under Section 77 of the Bankruptcy Act, *Continental Bank v. Rock Island Railway*, 294 U. S. 648, in which the clear distinction is drawn between the word, "*insolvency*", and the phrase, "unable to meet its debts as they mature". It is clear that the latter condition may exist in "reorganization" and



"composition" cases although the debtor has an excess of assets over liabilities.

In the *Bekins* case, 304 U. S. 27, 47, in speaking generally of proceedings for compositions under the Bankruptcy Act, this Court said:

"It is unnecessary to the validity of such a proceeding that it should result in an adjudication of bankruptcy."

In support of its position that the operating properties of the District and the lands within the District "cannot be disposed of as in the ordinary bankruptcy proceeding for the benefit of the debtor" (R. 365), the court below cited *Clough v. Compton-Delevan Irrigation District*, 12 Cal. (2d) 385, 388, 389, 85 Pac. (2d) 126, 128, wherein it is said:

"[1-3] There is, first, no lien nor resulting trust arising from the purchase of the bonds. The statute fully defines the relationship of bondholders, district and landowners. *Nowhere does it declare that the bondholder has a lien on the land itself, and it certainly does not recognize any trust for his sole benefit.* Section 29 provides that the title to land acquired by the district shall vest in the district, 'and shall be held by such district, in trust for, and is hereby dedicated and set apart to the uses and purposes set forth in this act.' The property is by this language impressed with the public use, and the trust is for all the purposes of the act. Payment of the bondholders is such a purpose, as we have held in the *Provident Land Corporation Case*, *supra*; but there are other purposes as well, and the bondholders cannot be con-

*sidered exclusive beneficiaries, even if the doubtful assumption be made that they, as individuals, are beneficiaries at all.* Indeed, it is futile to attempt to discover the 'beneficiaries' of the statutory trust created by section 29. It is enough to point out that it is an active trust for public uses and purposes, and to permit partition of the land which constitutes its corpus would mean the destruction of the trust, in violation of the statute. The same considerations of policy which make this property exempt from execution (see *El Camino Irrigation District v. El Camino Land Corporation*, *supra*) are equally applicable to any attempt to take the same by partition." (Italics ours.)

3. The financial statements of the District conclusively show that it cannot meet its debts as they mature under the bond indebtedness of \$733,000.

That the water supply available to the District is greatly inadequate for its needs is indisputably shown by the record. (R. 99-108.) Every farmer in the District has to maintain his own pumping plant in order to serve his crops with the water necessary to mature them. (R. 108.)

Petitioners contrast the bonded indebtedness per acre of Corcoran District with that of three other districts. (Br. p. 38.) Those three districts have perfect water supplies and the irrigators therein do not have to install and operate individual plants, which is the case in this District. The "Table of Water Costs" (R. 137) shows that the *annual* individual pumping costs in this District average \$8.30 per acre for the

irrigation of cotton and \$12.50 per acre for the irrigation of alfalfa.<sup>1</sup>

In its annual reports to the Districts Securities Commission the District included reports on the crops raised in the District. A summary of such crop reports for the years 1934 to 1938, inclusive, was received in evidence herein as Exhibit No. 5. (R. 124-128.) Exhibit No. 6 is a "Table of Water Costs" for the years 1934-1938, inclusive. (R. 137.) An examination of the crop reports and water costs shows that the farmers of the District have been operating at a loss. To illustrate this point we shall briefly consider the returns from cotton—the main crop of the District—for the years 1937 and 1938. As shown in Exhibit No. 6 (R. 137), the cost for water served *by the District* for cotton in 1937 and 1938 was \$1.80 and \$1.69 per acre, respectively. The *individual pumping cost* was \$8.30 per acre in addition—making a total water cost for cotton in 1937 of \$10.10 per acre, and in 1938 of \$9.99 per acre. The "value" per acre to the farmer for cotton in 1937 was \$5.70 per acre, and \$3.20 per acre in 1938. (R. 127, 128.) It is apparent that the "value" per acre of cotton in 1937 and 1938 was much less than the water costs—without considering the additional irrigation district tax of \$1.40 per acre in 1937 and \$1.50 per acre in 1938. (R. 127, 128.)

The Financial Statements of the District, introduced as Exhibit No. 7 (R. 140 to 143), cover the years 1929

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1. The comments of the trial judge on the inadequacy of the water supply of the District are set forth in R. 62, 63.

to 1938, inclusive. In the lowest bracket ("Assessment Data") of the first two pages of Exhibit No. 7, the "% Delinquent" for each fiscal year is given. It is noteworthy that the delinquencies ran as follows: 1930-1, 21.5%; 1931-2, 32.34%; 1932-3, 40.7%; 1933-4, 46.93%; 1934-5, 21.04%; 1935-6, 26.19%; and 1936-7, 13.93%. The last line of the bracket shows the "% Delinquent Jan. 10, 1939." The percentage there given is exclusive of the lands deeded to the District. (4,701.23 acres—9.1% of the area of the District—R. 122.) The said line shows a remarkable recovery in the percentage of delinquencies—the largest percentage remaining as of date Jan. 10, 1939, being 7.13% for 1933-4.

An examination of the statements discloses that the aforesaid remarkable recovery was largely due to the redemptions ("Tax certificates & interest") in 1937, which amounted to \$54,537.86, as contrasted with \$15,948.35 for 1936, \$18,020.97 for 1935, \$20,511.69 for 1934, \$5,946.62 for 1933, \$14,909.96 for 1932; and \$12,731.22 for 1931. *The large amount of redemptions in 1937 was undoubtedly due to the renewed confidence of farmers in the District due to the then assured assistance of R. F. C. in the refinancing of the District.*

On the bottom of the last two pages of Exhibit No. 7, the "Bond and Interest Default" is given. (R. 142, 143.) The first default shown is for bond principal—\$3,000 in 1933. Although the first actual default occurred in 1933, the item "7% Warrants Issued" under "Receipts" shows that warrants were issued in 1929,

1930, 1931, 1932 and 1933. As such warrants are in effect promissory notes, that means that the District had to borrow money in the period 1929-1933, inclusive, to pay the general expenses of the District. (R. 152.) That means, further, that the District kept the Bond Fund intact in the years 1929-1932, inclusive, by contributions from the General Fund. *It is certain that the District would have been in default in 1929, had it not drawn upon its General Fund to pay the bond interest due on July 1st of that year.*

Petitioners contend that the gross revenue of the District was sufficient to pay all the general expenses of the District and the matured bond principal and matured bond interest during the period 1933-1938, inclusive. To show the error of that contention we submitted to the court below and to the trial court, and attach hereto as Schedule A, an analysis of the Financial Statements of the District (Exhibit No. 7) for said years. Schedule A shows that following petitioners' hypothesis, the deficit on January 1st of each year, after paying the bonds and interest due on that day, would have been as follows:

January 1, 1934.....	\$29,202.53
“ 1935.....	61,124.86
“ 1936.....	72,917.23
“ 1937.....	86,941.56
“ 1938.....	40,791.88
“ 1939.....	57,787.53

With the exception of the hypothetical payment of bond principal and interest, all of the figures used in

Schedule A are taken from the Financial Statements (R. 140 and 141) showing the "Receipts" and "Disbursements". It is true that the item, "Capital Expenditures", under "Disbursements", includes money spent for mutual water stock, wells and gas engines. Without that expenditure, the amount of water supplied in the year of the expenditure, and the amount of money collected in water tolls, would have been materially less. Even if we should subtract the "Capital Expenditures" from the "Disbursements" for each year, a heavy deficit would remain on January 1 of each year. The "Capital Expenditures" are as follows (R. 140, 141): 1933, \$64.75; 1934, \$11,649.26; 1935, \$10,556.34; 1936, \$30,395.78; 1937, \$22,385.65; 1938, \$15,013.59. There is no way of telling how much the "water tolls" for each year would have been decreased if the "Capital Expenditures" had not been made. It is certain that they would have been materially lessened.

Schedule A is made on the basis that bond principal and interest payable January 1st of one year must be on hand December 31st of the preceding year. The interest paid to R. F. C. in 1937 and 1938 is deducted from the actual total disbursements for each of the years. As such interest payments are generally considered as refinancing accounts, by deducting them in the analysis we have presented the results in the most favorable way from the viewpoint of petitioners. As previously stated, the recovery of the District in 1937 should be attributed to the assistance of R. F. C. in the

plan of debt readjustment. It is certain that the financial status of the District would have been very different if R. F. C. had refused assistance.

4. The plan of debt composition proposed by the District is fair and equitable.

This point is excellently covered by the trial court in its opinion. (R. 74, 75.) The court below adopted the opinion of the trial court, and specifically held "that the plan proposed was fair and equitable." (R. 364.)

Petitioners (Br. pp. 58, 59) cite and quote from the opinion of the court below in *Fano v. Newport Hts. Irr. Dist.*, 114 F. (2d) 563, filed the same day the opinion herein was filed, September 5, 1940. The two opinions were written by Circuit Judge Stephens.

The Newport Hts. Irr. Dist. comprised approximately 1,500 acres only, a part of which had become residential rather than agricultural. Through money secured in large part from R. F. C., the District rehabilitated its irrigation system at a cost in excess of \$50,000. It was this heavy reconstruction cost which caused a deficit in the accounts of the District. On this point the Court said (114 F. (2d) 565):

"We think the deficit has been caused by the reconstruction of the system and the diversion of tax moneys to the payment therefor, a sufficient part of which moneys could have been allocated to the interest fund. Thus we see, it was not the disability of the District to support itself, but the payment for heavy betterments practically upon a cash basis that brought about the embarrassment."

The *Newport District* case serves to illustrate the care with which the court below has examined the records in these cases. At the time it had the Newport District's affairs under consideration, it was also examining the record in this case. It was after its careful examination of the record that it reached the conclusion that the opinion of the trial judge "correctly and sufficiently treats of the financial distress of the District and the plan for relief through the Reconstruction Finance Corporation, \* \* \*". (R. 364.)

In arguing that the security is many times the bonded indebtedness of the District, petitioners make much of the statement of the Secretary of the District that the value of lands in the District would run "from seventy-five to one hundred dollars an acre". (R. 262.) The only recent sales to which the Secretary referred were at the upper end of the District where the lands are of poorer quality and sold for \$12.50 per acre. (R. 261.) The so-called "market value" of agricultural lands is somewhat fictional. If we base that value on the ability of the land to pay in this District, it would necessarily be but little.

Regardless of the question of market value of lands, however, we must emphasize the fact that regarding lands in an irrigation district "there is no lien nor resulting trust arising from the purchase of the bonds." (*Clough v. Compton-Delevan I. D.*, 12 Cal. (2d) 388—quoted from hereinabove.) The lands can only be reached through the levy of assessments. The landowner cannot free his land of its bonded indebtedness by the payment of a stated amount. He must pay



his annual assessments when due, and as his neighbors default his tax burden becomes correspondingly greater. It is this "pyramiding" of taxes which defeats the application of any theory of market value of lands in a taxing agency.

To determine whether the plan of a taxing agency is fair the fundamental question must be, what can the debtor pay—what is the maximum bearable debt load of the District? It avails the bondholder nothing if that load is exceeded. This point is recognized by Chief Justice Hughes in the *Bekins* case (304 U. S. 53, 54), wherein he said:

"As the owners of property within the boundaries of the district could not pay adequate assessments, the power of taxation was useless. The creditors of the district were helpless."

On the question of the fairness of the plan herein, we direct attention to the fact that R. F. C., after its thorough examination of the properties of the District, and of the crop situation therein, refused to contribute over 65.791 cents on the dollar for the purchase of bonds. The District was forced to pay the remaining 9.209 cents to make up the 75 cents on the dollar demanded by the Bondholders' Committee.

II. SECTION 83 IS NOT UNCONSTITUTIONAL IN ITS APPLICATION HERE. THE FACT THAT LANDS WITHIN THIS DISTRICT LIE IN OTHER OVERLAPPING TAXING AGENCIES AND ARE SUBJECT TO PRIVATE MORTGAGES DOES NOT AFFECT THE PLAN OF COMPOSITION. (Pet. Br. p. 59.)

Petitioners argue that Section 83 is unconstitutional in its application here because it contained no provisions for bringing in (1) taxing agencies or bondholders of other taxing agencies which overlap this District, and (2) private mortgages upon lands within the District. Petitioners are unable to cite any authority at all in point for their bizarre theory. If it were tenable, it would put an end to all attempts to accomplish reorganizations or compositions under bankruptcy statutes. Regarding reorganizations, the lands and rights of way of railroads are often included in improvement districts, as well as school districts and other more common forms of taxing agencies.

In *Luehrmann v. Drainage Dist. No. 7*, 104 F. (2d) 696, 700, the trial court had found:

“When the lands become delinquent for drainage taxes they also generally become delinquent for State and County Taxes and for taxes to St. Francis Levee District, which latter overlaps the entire territory of petitioner. Hence there are three tax titles outstanding against such forfeited lands, one to the drainage district, one to the Levee district, and one to the State of Arkansas.”

On November 6, 1939, this Court denied the petition for writ of certiorari in the *Luehrmann* case, under the name, *Haverstick v. Drainage District No. 7*, 308 U. S. 604.

In disposing of this point in the *Merced* case, the court below said (114 F. (2d) 674):

“The obligations of mortgages or bonds of overlapping agencies are simply not affected by the plan.”

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III. R. F. C. DID OWN BONDS TAKEN UP, AND COULD AND DID GIVE ITS CONSENT TO THE PLAN OF COMPOSITION. (Pet. Br. p. 65.)

The principal argument of petitioners on this point is that R. F. C. is not, and was not, an owner of any bonds of the District, and that it was a mere lender of money to the District.

The same argument has been presented in all the recent bankruptcy cases in which the financing was done by R. F. C.

Judge Yankwich in his opinion herein carefully considered this point with reference to the record, beginning with the sentence, “There is no substance to the contention that the Reconstruction Finance Corporation is not a creditor.” (R. 71-74.)

In the *Merced* case, 114 F. (2d) 665-669, the court below very fully discussed the point under the caption, “Is Reconstruction Finance Corporation a Creditor Affected by the Plan?” At pages 668, 669, the court cited and quoted from the *Luehrmann* case, 104 F. (2d) 696, on this point with the following conclusion:

“[10] We agree entirely with the decision of the Court in the *Luehrmann* case, *supra*, and hold that R. F. C. is entitled to be classed as a ‘creditor affected by the plan.’ ”

As previously noted, certiorari was denied in the *Luehrmann* case, 308 U. S. 604.

The resolution of R. F. C. (Exhibit No. 9, R. 163) and the accepting resolution of the District (Exhibit No. 10, R. 192) constitute the contract between R. F. C. and the District. The two follow a standard form used generally by R. F. C. in cases of this kind. The acceptance by R. F. C. of the plan of debt composition of the District is set forth in Exhibit "B", attached to the amended petition to the District herein. (R. 11.)

The fact that the District in this case contributed a portion of the money for the purchase of the bonds by R. F. C. does not affect the established rule. The first loan approved by R. F. C., on June 27, 1934, was for \$442,000, for the purpose of purchasing the outstanding bonds at 59.959 cents on the dollar. The holders of approximately 56.34% of the bonds accepted that offer and deposited their bonds in escrow. (R. 158.) However, the opposition of the Bondholders' Committee was so great that the District had to abandon the plan of purchasing the bonds at that price. R. F. C. finally agreed to increase its loan so that 65.791 cents might be paid from it for each dollar of bond, and the District arranged to add 9.209 cents to meet the demand of 75 cents per dollar insisted upon by the Bondholders' Committee. (R. 159.) R. F. C. now holds 679 of the outstanding 733 bonds—which holding amounts to 92.6% of all outstanding.

The contribution by the District in the purchasing of the bonds emphasizes the fairness of the present

plan. R. F. C. did not feel justified in advancing beyond 65.791 cents on the dollar. The balance of the 75 cents demanded had to be made up by the District.

Other California Irrigation Districts have contributed some part of the price paid by R. F. C. for bonds. Among them are Banta-Carbona Irrigation District, whose plan of debt composition was confirmed by Judge Louderback on January 9, 1940, Glenn-Colusa Irrigation District, with plan confirmed by Judge Louderback on April 16, 1940, and Waterford Irrigation District, with plan confirmed by Judge Roche on February 29, 1940.

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**IV. THE PLAN OF COMPOSITION WAS NOT DISCRIMINATORY IN THAT R. F. C. AND NO OTHER BONDHOLDER WAS OFFERED NEW BONDS PLUS INTEREST AT 4%. (Pet. Br. p. 72.)**

The fact that the taxing agency has paid 4% interest per annum to R. F. C. for money expended by it in purchasing the bonds of the agency has been pressed in all of these cases by the objecting bondholders. Judge Yankwich treated the point in that part of his opinion beginning as follows (R. 74, 75):

“A study of the entire record and a history of the difficulties of this district leads to the inevitable conclusion of fairness and equitableness of the proposed plan. All bondholders are treated alike. The fact that interest was paid to the Reconstruction Finance Corporation does not militate against the fairness of the plan.”

In the *Merced* case, the Court considered this point in subdivisions [24] and [25], 114 F. (2d) 677. It therein quoted in support of its conclusion an excerpt from *Zavelo v. Reeves*, 227 U. S. 625, 632.

We have hereinabove cited the Arkansas case, *Luehrmann v. Drainage District No. 7*, in which this Court denied a writ of certiorari. (308 U. S. 604.) In that case in the District Court it was held with reference to the point now under consideration as follows (25 F. Supp. 380):

“I therefore uphold the plan as against the contention of unfairness because of full payment to the governmental agency and on the contrary believe in that respect it was not only fair but it is also quite evident that the success of the plan was dependent upon those two loans and the Government would not and could not have advanced the money without provisions for its full repayment.”

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V. SECTION 83 DOES APPLY TO DEBT COMPOSITIONS OF CALIFORNIA IRRIGATION DISTRICTS. (Pet. Br. p. 74.)

In the *Merced* case, the court below considered this point under the caption, “Jurisdiction of the Court under the Statute”, 114 F. (2d) 662, 663. It therein examined and quoted from the *Bekins* case, 304 U. S., page 51 and page 54, and reached the following conclusion (p. 663):

“The premise upon which the Appellants base their entire argument having fallen, there is nothing left to their point. The *Bekins* case held with-

out question that the Act is constitutional as applied to a California Irrigation District, organized under the same California Statute as the one here involved. That case is binding upon us."

This point was pressed before the court below and argued at length in the hearing before it on this series of cases in January, 1940. Since that time, the Supreme Court of California has decided the case of *Peoples State Bank v. Imperial Irr. Dist.*, 101 Pac. (2d) 466. (Rehearing denied May 16, 1940.) In that case the questions before the Court were clearly stated as follows (p. 467):

"The contentions of the appellant are (1) that an irrigation district organized under the laws of this state is a governmental agency and as such is not subject to said chapter X (now chap. IX) of the United States Bankruptcy Act, and (2) that the state has not given its consent to the filing of a petition for composition of its debts by an irrigation district under the Bankruptcy Act of the United States, as amended by the enactment of said chapter X (now chap. IX) thereof."

The Court then proceeded to show by quoting numerous excerpts from the *Bekins* case that the questions had been determined adversely to the contentions of appellant by this Court in that case. The California court concluded its consideration of the *Bekins* case as follows (p. 468):

"[1, 2] The *Bekins* case, in our opinion, effectually establishes the validity and constitutionality of both chapter 4 of the 1934 Extra Session Stat-

utes, and chapter X (now chap. IX) of the United States Bankruptcy Act. We are in thorough accord with the views therein expressed, and particularly in respect to its conclusion as to the constitutionality of the statute of our own state. (Chap. 4 of the 1934 Extra Session Statutes.)”

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#### VI. CONCLUSION.

It is respectfully submitted that the petition for writ of certiorari should be denied.

Dated, San Francisco, California,  
December 9, 1940.

F. G. ATHEARN,  
MILTON T. FARMER,  
*Attorneys for Respondent.*

A. E. CHANDLER,  
*Of Counsel.*

(Schedule A Follows.)



Schedule A

**Analysis of Financial Statements**  
Corrobran Irrigation District

for the Years 1933-1934-1935-1936-1937-1938.  
**Showing BALANCES that would have occurred if the District had paid BOND & INTEREST MATURITIES each year from the GROSS REVENUE of the District.**

	1933 (R-140)	
Dec. 31, 1933		
Total Disbursements in 1933	\$107,642.27	
DEDUCT		
Bonds paid in 1933	\$ 7,000.00	
Coupons Paid in 1933	26,597.60	33,597.60
		<u>74,044.67</u>
Amount required for Bond Service in 1933 and Jan. 1, 1934, from CASH BALANCE Jan. 1, 1933, and Collections for the year 1933.		
Jan. 1, 1933, Bond Principal	\$10,000.00	
Bond Interest	22,200.00	
July 1, 1933, Bond Interest	21,000.00	
Jan. 1, 1934, Bond Principal	10,000.00	
Bond Interest	21,900.00	<u>86,000.00</u>
Jan. 1, 1934		
Cash required to meet obligations in 1933 and Jan. 1, 1934		\$160,044.67
Jan. 1, 1933		
Cash on hand from 1932 Collections	\$ 28,856.50	
Dec. 31, 1933	108,464.72	<u>137,321.22</u>
Total Cash Collections in 1933		137,321.22
Less 7% Warrants sold in 1933	6,479.08	<u>130,842.14</u>
Jan. 1, 1934		
Deficit if Bonds and Coupons had been paid.		<u>\$ 29,202.53</u>

**Analysis of Financial Statements**  
**Corcoran Irrigation District**  
 for the Years 1933-1934-1935-1936-1937-1938.  
**Showing BALANCES that would have occurred if the District had paid BOND & INTEREST**  
**MATURITIES each year from the GROSS REVENUE of the District.**

	1934 (R-141)	
Dec. 31, 1934	Total Disbursements in 1934	\$110,023.39
	DEDUCT Coupons Paid in 1934	16,510.07
		<hr/> 83,513.32
	Amount required for Bond Service July 1, 1934, and Jan. 1, 1935, from Collections for the year 1934.	
	July 1, 1934, Bond Interest	\$ 21,600.00
	Jan. 1, 1935, Bond Principal	10,000.00
	Bond Interest	21,600.00
		<hr/> 53,200.00
	Add Deficit Jan. 1, 1934	29,202.53
	Add Interest 7%—1 year on deficit	<hr/> 2,044.16
Jan. 1, 1935	Cash required to meet obligations in 1934 and Jan. 1, 1935.....	\$177,960.03
Dec. 31, 1934	Total Cash Collections in 1934	<hr/> 116,835.17
Jan. 1, 1935	Deficit if Bonds, Coupons and Jan. 1, 1934, deficit had been paid.....	<hr/> \$ 61,124.86

for the Years 1933-1934-1935-1936-1937-1938.

**Showing BALANCES that would have occurred if the District had paid BOND & INTEREST MATURITIES each year from the GROSS REVENUE of the District.**

	1935 (R-141)		
Dec. 31, 1935	Total Disbursement in 1935	\$86,664.23	
	DEDUCT Coupons Paid in 1935	820.05	
		<hr/>	
	Amount required for Bond Service July 1, 1935, and Jan. 1, 1936, from Collections for the year 1935	85,844.18	
	July 1, 1935, Bond Interest	\$21,300.00	
	Jan. 1, 1936, Bond Principal	20,000.00	
	Bond Interest	21,300.00	
		<hr/>	
	Add Deficit Jan. 1, 1935	61,124.86	
	Add Interest 7%—1 year on deficit	4,278.73	
		<hr/>	
Jan. 1, 1936	Cash required to meet obligations in 1935 and Jan. 1, 1936	\$213,847.77	
Dec. 31, 1935	Total Cash Collections in 1935	140,930.54	
		<hr/>	
Jan. 1, 1936	Deficit if Bonds, Coupons and Jan. 1, 1935, deficit had been paid	\$ 72,917.23	
		<hr/>	

**Analysis of Financial Statements**  
**Corcoran Irrigation District**  
 for the Years 1933-1934-1935-1936-1937-1938.  
**Showing BALANCES that would have occurred if the District had paid BOND & INTEREST**  
**MATURITIES each year from the GROSS REVENUE of the District.**

	1936 (R-141)	
Dec. 31, 1936	Total Disbursements in 1936	\$102,671.92
	DEDUCT Coupons paid in 1936	1,007.84
		<hr/> 101,664.08
	Amount required for Bond Service July 1, 1936, and Jan. 1, 1937, from Collections in the year 1936.	
	July 1, 1936, Bond Interest	\$20,700.00
	Jan. 1, 1937, Bond Principal	20,000.00
	Bond Interest	20,700.00
		<hr/> 61,400.00
	Add Deficit Jan. 1, 1936	72,917.23
	Add Interest 7%—1 year on deficit	5,104.20
		<hr/> 78,021.43
Jan. 1, 1937	Cash required to meet obligations in 1936 and Jan. 1, 1937.....	\$241,085.51
Dec. 31, 1936	Total Cash Collections in 1936	154,143.95
Jan. 1, 1937	Deficit if Bonds, Coupons and Jan. 1, 1936, deficit had been paid.....	<hr/> \$ 86,941.56

**Analysis of Financial Statements**  
**Oceorona Irrigation District**  
**for the Years 1933, 1934, 1936, 1937, 1938.**  
**Showing BALANCES that would have occurred if the District had paid BOND & INTEREST**  
**MATURITIES each year from the GROSS REVENUE of the District.**

	1937 (R-141)	
Dec. 31, 1937	Total Disbursements in 1937	\$168,011.46
	DEDUCT \$92.09 per Bond for 648 Bonds deposited in Escrow for RFC	\$59,674.32
	Interest Paid to RFC	13,967.81
	On Account of Coupon	16.73
		73,658.86
		<hr/>
		94,352.60
	Amount required for Bond Service July 1, 1937, and Jan. 1, 1938, from Collections in 1938.	
	July 1, 1937, Bond Interest	\$20,100.00
	Jan. 1, 1938, Bond Principal	20,000.00
	Bond Interest	20,100.00
		<hr/>
		60,200.00
	Add Deficit Jan. 1, 1937	
	Add Interest 7%—1 year on deficit	86,941.56
		<hr/>
		6,085.90
Jan. 1, 1938	Cash required to meet obligations in 1937 and Jan. 1, 1938.	
Dec. 31, 1937	Total Cash Collections in 1937	\$247,580.06
		<hr/>
		206,788.18
Jan. 1, 1938	Deficit if Bonds, Coupons and Jan. 1, 1937, deficit had been paid.	\$ 40,791.88

**Analysis of Financial Statements**  
**Corcoran Irrigation District**  
**for the Years 1933-1934-1935-1936-1937-1938.**  
**Showing BALANCES that would have occurred if the District had paid BOND & INTEREST MATURITIES each year from the GROSS REVENUE of the District.**

	1938 (R-141)	
Dec. 31, 1938	Total Disbursements in 1938	\$88,014.39
	DEDUCT \$92.09 per Bond for 30 Bonds deposited in Escrow for RFC	\$ 2,762.70
	Interest Paid to RFC	17,467.41
		<u>\$67,784.18</u>
	Amount required for Bond Service July 1, 1938, and Jan. 1, 1939, from Collections for 1938.	
	July 1, 1938, Bond Interest	\$19,600.00
	Jan. 1, 1939, Bond Principal	20,000.00
	Bond Interest	<u>19,600.00</u>
		59,000.00
	Add Deficit Jan. 1, 1938	40,791.88
	Add Interest 7%—1 year on deficit	<u>2,856.80</u>
Jan. 1, 1939	Cash required to meet obligations in 1938 and Jan. 1, 1939	\$170,432.66
	Total Cash Collections in 1938	112,645.13
Dec. 31, 1938	Deficit if Bonds, Coupons and Jan. 1, 1939, deficit had been paid	<u>\$ 57,787.53</u>
Jan. 1, 1939		

(Note 1): The bond interest given in the above schedule is the correct amount of interest due on the dates specified. To illustrate: On Jan. 1, 1933, there was due interest for six months on \$740,000 at 6% per annum, amounting to \$22,200. On July 1, 1933, there was due interest for six months on \$730,000 at 6% per annum, amounting to \$21,900. The total of the two payments for 1933 is \$44,100, and not \$43,800 as indicated in Morris Exhibit A (R. 299).

(Note 2): Interest at 7% is charged each year on the deficit shown on Jan. 1 of that year so that rate would have to be paid (1) for money borrowed on previous years and (2) on unpaid bonds or coupons as provided in Section 21a of the Corcoran Irrigation District Act.

*Due service and receipt of a copy of the within is hereby admitted*

*this \_\_\_\_\_ day of December, 1940.*

\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_  
*Attorneys for Petitioners.*





FILED

JAN 30 1941

CHARLES ELMORE CROPLE  
CLERK

*gls.*

# In the Supreme Court

OF THE  
United States

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OCTOBER TERM, 1940

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No. 589

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A. A. NEWHOUSE and MARY E. MORRIS,  
*Petitioners,*

vs.

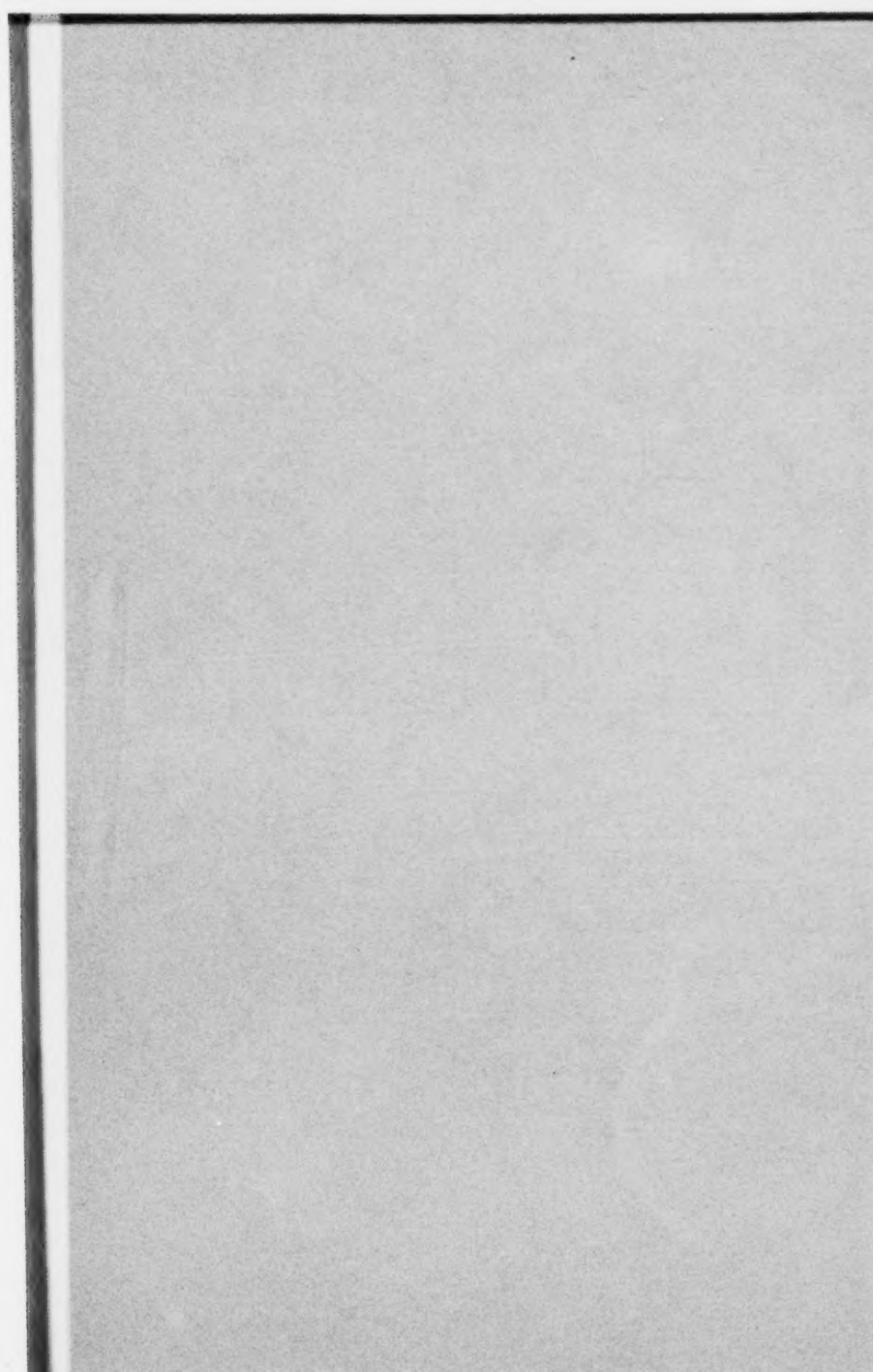
CORCORAN IRRIGATION DISTRICT,  
*Respondent.*

PETITION FOR A REHEARING.

---

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**In the Supreme Court**  
**OF THE**  
**United States**

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OCTOBER TERM, 1940

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A. A. NEWHOUSE and MARY E. MORRIS,  
*Petitioners,*

VS.

CORCORAN IRRIGATION DISTRICT,  
*Respondent.*

**PETITION FOR A REHEARING.**

---

*To the Honorable Charles Evans Hughes, Chief Justice of the United States, and to the Associate Justices of the Supreme Court of the United States:*

Come now the petitioners herein, A. A. Newhouse and Mary E. Morris, and present this, their petition for a rehearing of the petition for a writ of certiorari herein, and in support thereof respectfully show:

**I. THE DEBTOR IS NEITHER INSOLVENT NOR UNABLE TO PAY ITS MATURED DEBT AND THE PLAN IS NOT FAIR AND EQUITABLE.**

While the respondent Corcoran Irrigation District is a public agency and its property is exempt from execution, the local law of California in effect secures the bonds by the lands of the district. Thus in *Provident Land Co. v. Zumwalt*, 12 Cal. (2d) 365, the Supreme Court of California in a carefully considered opinion said:

“\* \* \* the lands remain in trust and the district exercises its powers, however broad, as a trustee. Once it is made clear that the lands are held in trust, it necessarily follows that their proceeds, whether by sale or lease, are likewise subject to the trust.”

The court then considering whether payment of the bondholders is one of the objects of the trust, declared:

“The land is the ultimate and only source of payment of the bonds. It can never be permanently released from the payment of the bonds until they are paid.”

The court below disregard our showing that the district is not insolvent in the bankruptcy sense and that it is in fact able to pay its debts as they mature, declaring:

“The principle of ordinary or private bankruptcy that the assets of the bankrupt, including his property, must be effectively applied to the debts, is sought to be applied to the situation before us. The bankruptcy of a public agency, however, is very different from that of a private person or concern.” (14 Fed. (2d) 690.)

However, this same court on the same day in *Fano v. Newport Heights Irrigation District*, 114 Fed. (2d) 563, 565, declared:

"It is undoubtedly true that the District has not funds in hand to fully pay this due interest and in that sense is insolvent, but it is not only far from insolvent in the bankruptcy sense, but owns debt free, except for the interest mentioned, assets in value many times the indebtedness, \* \* \*"

and refused to confirm the plan of this irrigation district.

There is thus a disagreement amongst the decisions of the Circuit Court of Appeals of the same Circuit.

This public debtor is neither insolvent nor unable to pay its debts as they mature.

a. The bond debt is \$733,000 principal, plus \$197,-104.78 coupons, plus \$44,509.58 penalty interest. (R. 143.)

b. Unpaid matured principal and interest totals \$344,614.36. (R. 143.)

The plan of composition offers to pay the creditors \$484,500.

The capital assets of the debtor amount to \$1,487,-216.53. (R. 143.)

And the bare and raw lands (exclusive of buildings and improvements) are of the present actual value of \$4,525,000 as established by the trial judge himself. (R. 34, 35.)

Thus this court, in denying our petition for a writ of certiorari has for guidance of all lower courts ap-

proved a plan which offers less than one-tenth the value of bankrupt's assets.\*

On the other side of the ledger the district has on hand cash \$135,609.49 and a cash reserve on deposit with the R.F.C. \$70,027.14. (R. 143.) It disbursed to the bondholders on the refunding program \$62,437.02. (R. 141.)

In addition to this it has purchased out of surplus moneys capital assets consisting of water stock of the total of \$94,937.29 (R. 143), a large part of which was purchased since the district went into default.

This is a total liquid asset, mainly cash, of \$362,990.94, or practically \$20,000 more than the total amount currently due on its alleged indebtedness, counting principal and interest.

Thus this court approves a plan where the debtor is neither insolvent nor unable to pay its debts as they mature. No such yardstick has ever been applied by this court to a private bankrupt. If we concede there was temporary inability to meet maturities on the bonds of the district after principal began to mature, that was no just reason for reducing the district's bonded indebtedness approximately one-half (counting principal and interest) when Section 83 of the bankruptcy act provides for plans which may allow

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\*This admittedly does not appear from the opinion, but the court will take judicial notice of the fact that there are one hundred irrigation districts in California. They have an association which is closely knit. There are over 20 bankruptcy plans of these irrigation districts now in the courts of California. This case and the *Merced Irrigation District* case are considered as the leading cases for the guidance of lower courts and in fact four appeals now pending in the Ninth Circuit Court of Appeals are by court order to be dismissed if the petitions are denied in this and the *Merced* cases.



extensions of time and when the result so plainly was to deprive security holders of security which the law accorded to them.

If the judgment in the case of *Fano v. Newport Heights Irrigation District* places a correct construction on the words "fair and equitable", this case nullifies the ruling and leaves confusion in the rulings of the same court. We earnestly appeal to the court to rule that a plan is not "fair and equitable" which accords to bondholders but one-tenth of the security behind their bonds. In *Case v. Los Angeles Products Company*, 308 U. S. 106, 84 L. ed. 110, this court ruled that the use of the words "fair and equitable" was to restrain putting into effect a confiscatory plan.

---

## II. THE RECONSTRUCTION FINANCE CORPORATION CANNOT VOTE THE BONDS IT HOLDS.

The Statute, Section 83 (d) 11 U. S. C. 403 (d), provides that the plan shall not be confirmed until it has been accepted in writing by creditors holding "two-thirds of the aggregate amount of claims of all classes affected by such plan \* \* \* but excluding claims owned, held or controlled by the petitioner; \* \* \*"

Now the very plan of composition (R. 9) discloses that \$92.09 of every \$750 paid the creditors is to be furnished from funds of the district. The district has already disbursed over \$62,437.02 in the purchase of the bonds from the original bondholders now held by the Reconstruction Finance Corporation. (R. 141.) Although that corporation holds the bonds, a trust

resulted in favor of the district and these bonds are all "owned" or "controlled" by the district and should not have been counted by the trial judge as votes in favor of the plan of composition. Without this vote the decree fails, because there was no other consenting creditor than the Reconstruction Finance Corporation.

It is respectfully submitted that assuming that the bankruptcy power of Congress does extend to these districts and that such is now the law, nevertheless this court should apply the fundamental principle of private bankruptcy that a plan shall be "fair and equitable" in order to come within the bankruptcy power and it should rule that no exception prevails in favor of an irrigation district or a public debtor. A review of this case should be granted in order to establish that principle as a part of the general law, as well as to iron out the differences between the decisions of the lower court which we have pointed out.

For the foregoing reasons it is respectfully urged that this petition for a rehearing be granted, and that a writ of certiorari be issued out of and under the seal of this honorable court as prayed for in the petition for writ of certiorari herein.

Dated, Berkeley, California,  
January 24, 1941.

Respectfully submitted,

RALPH R. ELTSE,  
W. COBURN COOK,

*Attorneys for Petitioners.*

GEORGE CLARK,  
*Of Counsel.*

## CERTIFICATE OF COUNSEL.

We, Ralph R. Eltse and W. Coburn Cook, counsel for the above-named petitioners, do hereby certify that the foregoing petition for a rehearing of this cause is presented in good faith and not for delay.

Dated, Berkeley, California,

January 24, 1941.

RALPH R. ELTSE,

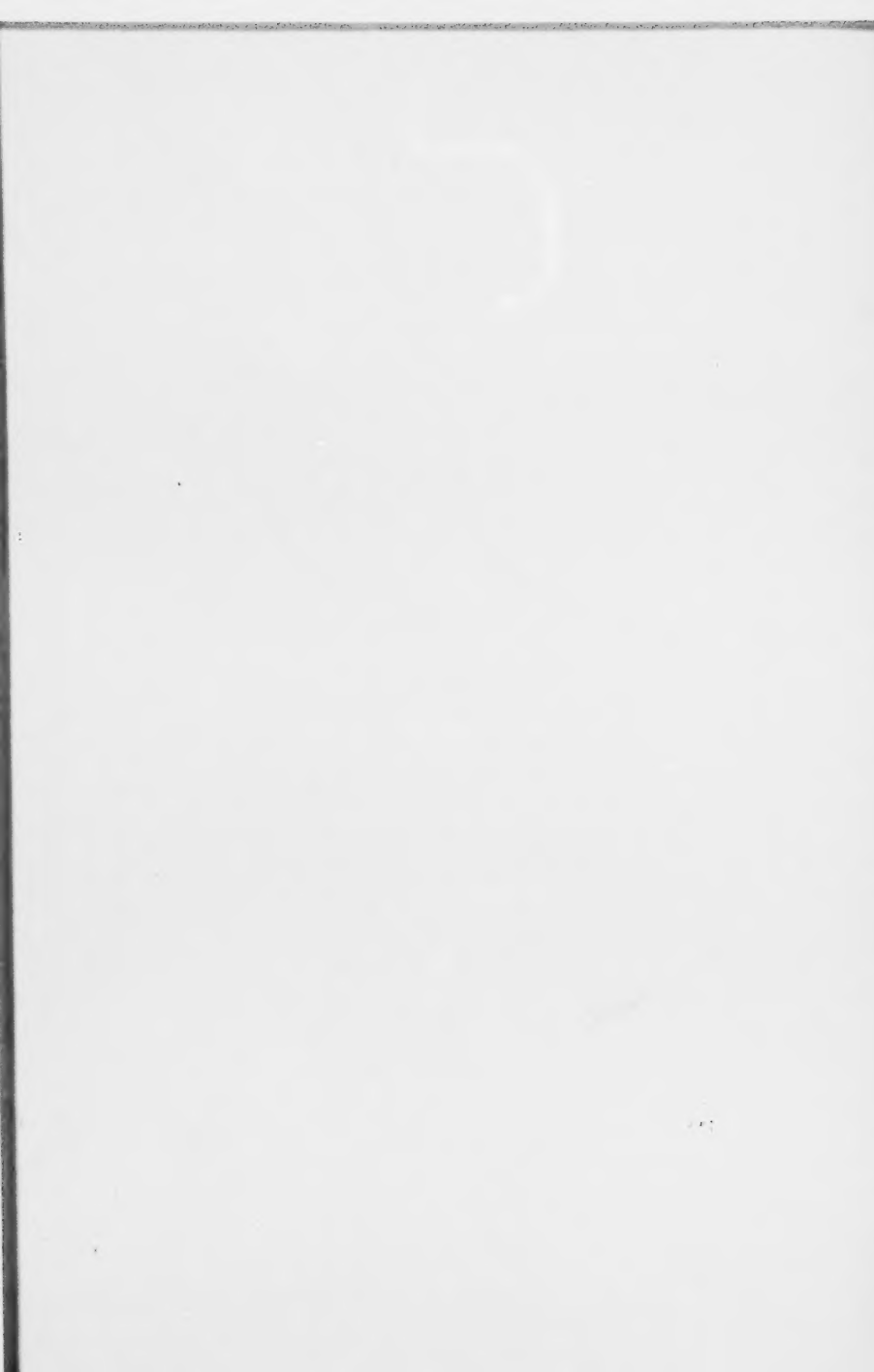
W. COBURN COOK,

*Counsel for Petitioners.*

*Due service and receipt of a copy of the within is hereby admitted*

*this \_\_\_\_\_ day of January, 1941.*

\_\_\_\_\_  
\_\_\_\_\_  
*Attorneys for Respondent.*



Vol 31  
**In the Supreme Court**

OF THE  
**United States**

OCTOBER TERM, 1940

No. **591**

Office - Supreme Court, U. S.

**FILED**

NOV 22 1940

**CHARLES ELMORE DROPLEY**  
CLERK

PACIFIC NATIONAL BANK OF SAN FRANCISCO,  
a national banking association, et al.,  
*Petitioners,*

vs.

MERCED IRRIGATION DISTRICT,  
*Respondent.*

**PETITION FOR A WRIT OF CERTIORARI  
to the United States Circuit Court of Appeals  
for the Ninth Circuit  
and  
SUPPORTING BRIEF.**

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# In the Supreme Court

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OCTOBER TERM, 1940

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No.

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PACIFIC NATIONAL BANK OF SAN FRANCISCO,  
a national banking association, et al.,

*Petitioners,*

VS.

MERCED IRRIGATION DISTRICT,

*Respondent.*

**PETITION FOR WRIT OF CERTIORARI**  
**to the United States Circuit Court of Appeals**  
**for the Ninth Circuit.**

---

*To the Honorable Charles Evans Hughes, Chief Justice of the United States, and to the Associate Justices of the Supreme Court of the United States:*

Petitioners pray that a writ of certiorari issue to review the decision (R. 1063) of the Circuit Court of Appeals for the Ninth Circuit made in the above en-

titled cause on September 5, 1940, which affirms the decision of the District Court for the Southern District of California, Northern Division, rendered against Petitioners on February 21, 1939 (R. 220).

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### **SUMMARY STATEMENT OF THE MATTER INVOLVED.**

This is a proceeding brought by the respondent, Merced Irrigation District, a California irrigation district, for readjustment of its debts under what is now Chapter IX of the Bankruptcy Act of 1898, as amended (11 USC, §§ 401-404). The trial court rendered an interlocutory decree confirming the plan, and its decision was affirmed by the court below.

### **Our view of the case, briefly stated.**

Stated as briefly as possible, our view of the case is this: The District's bonded debt (including five years' unpaid interest) is, according to its records, \$21,148,706.28. Its other debts are inconsiderable.

The plan proposes to scale down the bonded debt to \$8,338,011, by paying 51.501¢ on the dollar of principal, and nothing for accrued interest.

The plan follows the terms of a loan, in 1934, by the Reconstruction Finance Corporation (hereinafter referred to as R. F. C.) made to the District, designed to pay the amount offered by the plan, and conditioned on surrender of 85% of the bonds on those terms.

Although the trial court found that the plan is "fair, equitable and for the best interests of its credi-

tors", it made no finding (nor did the court below) concerning the value of the District's corporate assets, or the value of the privately owned lands charged with payment of the bonds, or the past, present or future income of the District, whether actual or potential.

We believe that the evidence establishes the following propositions:

(1) The present value of the District's corporate assets (acquired almost entirely with the proceeds of the bonds), as shown by its records, is \$21,319,901.26.

These assets include a large hydro-electric plant and one of the largest dams in the world. The District estimates the life of the dam and reservoir at one hundred years from 1926.

(2) The value of the privately owned lands in the District (charged with payment of the bonds) is in excess of \$40,000,000, and is attributable largely to the existence of the irrigation system, paid for with the proceeds of the bonds.

(3) The average annual corporate income of the District during its entire life (i. e., since its creation in 1919) has been adequate to amortize, in thirty-five years at 4% (the term of the refunding bonds proposed by the plan), a debt approximately twice the amount offered by the plan.

(4) No evidence suggests that the District's future income will be less than its past income. On the contrary, substantial considerations indicate that future income will much exceed the income of the past. For example:



(a) An important part of the District's revenue comes from the sale of the electricity generated to a private power company, under a contract expiring in 1964 (R. 945-6). The amount received for power varies directly with the amount produced, which in turn varies with rainfall. Past operation of the hydro-electric plant (completed late in 1926) includes the lowest consecutive nine years of rainfall in the history of the District so far as existing records (available since 1870) show.

(b) The District's past life includes an unprecedented depression in agricultural prices, which in 1932 fell to 44 per cent. of the 1909-14 average, which period is generally accepted as a base.

(c) During much of its past life the District has been in process of development, much new land being gradually brought under cultivation, and much experience gained in adaptation of particular crops to particular locations. General prices and agricultural prices have, for several years now, exceeded the 1909-14 average.

#### **The powers and duties of California irrigation districts.**

Space does not permit detailed treatment; but the following quotation from a decision of the Supreme Court of California states briefly the basic provisions of the California statutes governing irrigation districts:

"The basic provision indicating the normal remedy of the bondholders is section 33 of the act, which read prior to 1935: 'Said bonds and the interest thereon shall be paid from revenue derived from an annual assessment upon the land within the district; and all the land within the district shall be and remain liable to be assessed for such payments as hereinafter provided.' Section 39 provides that the directors shall levy an assessment upon the lands in an amount sufficient to raise the interest and principal coming due on the bonds. The assessment is a lien against the property assessed (sec. 40), and upon delinquency, the property must be sold to the district (sec. 43). It may be redeemed within three years or at any time thereafter before a deed has been delivered (sec. 47)."

*Provident Land Corp. v. Zumwalt*, 12 Cal. (2d) 365, 370.

**The issue of fairness is not disposed of by the findings or the opinions below.**

The trial Court found, simply in the language of the statute:

"That the plan of composition as offered by the petitioner herein is fair, equitable and for the best interests of its creditors \* \* \*" (R. 214).

But the trial Court's opinion reads in part:

"We consider as most forceful, irrefutable evidence of the fairness of the plan the indisputable fact that more than 90 per cent. of the invested capital in the bonds of the District has taken advantage of it. The legal requirement of debt com-

position under Chapter IX of the Bankruptcy Act has been exceeded by nearly 25 per cent. of the affected invested capital" (R. 176).

And as this Court held in

*Case v. Los Angeles Lumber Products Co.*, 308

U. S. 106, 114,

the statute there involved (Section 77B of the Act) laid down two requirements, namely (a) that a given percentage of creditors must consent to the plan, and (b) that the judge should not approve the plan unless satisfied that it is "fair and equitable".

The present statute, in substantially identical language, also imposes these two requirements.

It is, we submit, proper to refer to the trial Court's opinion where, as here, the opinion demonstrates that the court based a finding largely on irrelevant evidence. See:

*American Propeller & Mfg. Co. v. U. S.*, 300

U. S. 475, 479;

*Los Angeles Gas & Electric Co. v. Railroad*

*Commission*, 289 U. S. 287, 320.

The opinion, moreover, is incorporated into the findings (R. 210).

Such a finding will not sustain the decree: On appeal the Court either orders a new trial or itself examines the evidence, makes a finding one way or the other, and affirms or reverses accordingly:

*Mayo v. Lakeland Highlands Canning Co.*, 309

U. S. 310, 316, 317, 322.

See also, for example,

*Saari v. Wells Fargo Express Co.*, 109 Wash.  
415,

where the Court said:

“In cases tried by the court, we ordinarily consider that improper and incompetent evidence is given no prejudicial weight or credence, but here the contrary affirmatively appears. The report of Benjamin to the police department was improperly admitted, and was given undue weight and improper analysis by the trial court.”

*Metropolitan State Bank v. McNutt*, 73 Colo.  
291:

“The general rule that it is presumed that the court considered only competent evidence cannot be applied here, because it is shown by the bill of exceptions that the court rested its conclusions on evidence which is not competent on the issue in question.”

See also,

*In re Welsh*, 5 F. (2d) 918.

The finding that the plan is “fair and equitable” is a mere conclusion of law.

The decision of this Court in

*Northern Pacific Ry. Co. v. Boyd*, 228 U. S.  
482, and

*Case v. Los Angeles Lumber Products Co.*, 308  
U. S. 106, 113,

make it clear that a finding that a plan is “fair, equitable and for the best interests of creditors” is

a mere conclusion of law, which must be based on findings of ultimate facts sufficient to support it.

A very similar problem is presented in California by a statute providing that specific performance shall not be granted unless the contract is fair and reasonable and supported by adequate consideration. Under this statute the courts hold that a finding, merely in the language of the statute, will not support a judgment, since to hold such a finding sufficient would confer on the trial courts unlimited power to follow their individual ideas concerning the content of the requirement of fairness. Thus, in

*Miller v. Gusta*, 103 Cal. App. 32,

the Court said:

“\* \* \* the trial court instead of finding the facts from which the justness and reasonableness of the contract and the adequacy of the consideration would follow as a conclusion of law simply found ‘that said contract is fair and equitable and that the consideration \* \* \* is an adequate consideration’. Under the authorities above quoted this is a bald conclusion of law. It is impossible from this finding for this court to know on appeal what value the court put on any of the properties involved in the exchange. Nor can we even conjecture in view of the sharp conflict in the testimony what values the trial court may have had in mind, or what sort of contract in the trial judge’s opinion would be fair and equitable or what consideration adequate. The values might, if they had been found by the trial court, be so disproportionate as to lead this court to disagree with the trial court’s conclusion as to the fairness

of the contract and the adequacy of the consideration. As to that we are left in the dark."

**The opinions below do not supply the lack of findings on the fairness of the plan.**

Even assuming that the insufficiency of the finding on the issue of fairness might be supplied by what is said or implied in the opinion of the trial Court, the fact is that its opinion contains nothing which could do so.

**Treatment of fairness in trial court's opinion.**

The trial Court's opinion contains the following matter relevant to the question of fairness:

The Court expresses its belief in the "inability of the District to service the outstanding bonds under the applicable laws of the State of California" (R. 169).

It states that the District was saved from collapse by the R. F. C. loan of 1934 (R. 174), because

"at the time default occurred in the bonds in 1933 the land of the District as a whole did not and could not be made to pay its cost of operation and consequently the land owners were unable to pay the assessments to service the bonds. This condition of delinquency continued and even became more aggravated by pyramiding unpaid assessments under applicable state laws year after year, until shortly prior to the availability of the plan embodied in the petition now before this court it had reached an aggregate delinquency of 62 per cent" (R. 175).

(We later show that the primary difficulty with this District resulted from wide fluctuations of income, coupled with the inexorable requirement of the statute (since amended to remove the difficulty), that the District shall levy assessments each year sufficient to meet current requirements plus all past defaults.)

The Court then states our contention that the District can easily pay much more than is offered by the plan. The Court answers with two propositions: First, that

“it was the more than 90 per cent. of the bondholders who took advantage of the R. F. C. composition agreement and transaction which made it possible for the District to save itself from financial ruin and thereby to a major degree brought about the present fiscal situation which the records in evidence show exists in the District.” (R. 176.)

Secondly, the court states that the large proportion of bondholders who have accepted the offer of 51.501¢ on the dollar is “forceful, irrefutable evidence of the fairness of the plan” (R. 176).

The court then mentions a proposal by these petitioners of a modified plan, and holds that it is inadmissible because it would give an undue advantage to these petitioners as compared with the 90 per cent. of bondholders who irrevocably accepted 51¢ on the dollar (R. 176), and also because our proposed modification, if adopted, would upset the District's relations with the R. F. C., which cannot be compelled

to change its contract with the District. In this behalf the Court says that our proposal

“would jeopardize if not injuriously upset present and prospective necessary improvements in the District, throw its entire contractual arrangement with the Reconstruction Finance Corporation into uncertainty, and encourage unjustifiable delay in the adjustment and settlement of the financial status of the District. The R. F. C. has signified no willingness to advance more money to the retirement of the bonds than it has under the contract already made, and it cannot be required to do so by this court. We cannot alter the agreement under which the District and all financially interested in it were saved from forced liquidation which would have caused greater loss than the bond investors are to take under the plan.” (R. 178.)

We had argued (and do so again later) that the revenue of the District from sale of electric power is a very important factor to be taken into account in considering the District's ability to pay. The Court rejects this contention on the ground that power revenue, being dependent in amount upon rainfall, is not a safe basis for estimating future revenue. In this connection the Court says that

“the experiences of the past, as shown by the record before us, do not warrant a finding that power revenue conditions similar to those existing will continue in the future, and it would be injudicious to venture the further financial ability of the District to meet its obligations upon



problematical water sources or conditions. This would be too dubious a situation to warrant adoption by the court." (R. 178-9.)

**Treatment of fairness by the  
Circuit Court of Appeals.**

The Court below (the Circuit Court of Appeals) has little to say on the question of the factual fairness of the plan.

The Court says that the District was in serious distress in 1932 and that "some plan had to be worked out to refinance if anything at all were to be salvaged on the bonds" (R. 1058). The Court then says concerning the ability of the District to pay, that certain of our arguments are "illustrative of the truth of the statement of the District in its brief, 'there is no yardstick that can measure the ability to pay with certainty' " (R. 1059). The Court then quotes from the trial Court's opinion where the latter Court argued that the present condition of the District is attributable to the surrender of over 90 per cent. of the bonds in the past (R. 1059). The Court then refers in general terms to the evidence of fairness put forward by the District, and says (without any analysis) that this evidence supports the conclusion that the plan is fair and equitable (R. 1060).

**Summary of action of the Courts  
below concerning fairness.**

The fact is, then, that neither the findings nor either of the opinions arrive at any conclusion whatever as to the value of the District's corporate properties, or the value of the lands charged with payment of the bonds, or the past income of the District as evidencing ability to pay, or the potential ability of the District to pay, whether present or future. We submit, therefore, that the decision cannot stand unless this Court, upon examination of the evidence, should find that the ultimate facts support the conclusion of law that the plan is fair, equitable and for the best interests of the creditors.

The other questions presented are discussed in the brief attached hereto.

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**OPINIONS BELOW.**

Opinion of the trial Court: R. 168, 25 F. Supp. 981.

Opinion of the Circuit Court of Appeals: R. 1015, 114 F. (2d) 654.

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**JURISDICTION.**

The decision of the Circuit Court of Appeals was rendered September 5, 1940 (R. 1062). A petition for rehearing was filed October 3, 1940 (R. 1064), and was duly entertained and denied October 15, 1940 (R. 1064). The mandate has been stayed until forty

days after October 15, 1940, and thereafter until disposition of the matter by this Court (R. 1065).

The jurisdiction of this Court is invoked under Section 240(a) of the Judicial Code (28 U. S. C. §347(a)).

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### **QUESTIONS PRESENTED.**

1. Is a plan of composition fair under the Municipal Bankruptcy Statute which offers less than half the amount due (as this one does), when the security behind the debt greatly exceeds the amount offered, and when the income of the debtor is sufficient to pay much more than the amount offered by the plan?

2. Was it error, as we contend, to hold the plan fair without making any finding, or expressing any opinion, concerning the value of the District's corporate assets, or the value of the privately owned lands charged with payment of the bonds, or the past, present or future income of the District, whether actual or potential?

3. Was it error, as we contend, to hold the plan fair on the grounds (expressed in the opinions) (a) that some relief was necessary in 1933; (b) that the surrender to R. F. C. of 90 per cent of the bonds (in 1935) greatly relieved the situation, and was largely the cause of the District's present ability to pay; (c) that the proportion of bonds surrendered is "irrefutable evidence" that the plan is fair; (d) that no modification of the plan is feasible, because the Court

should not disturb the R. F. C. contract, and cannot alter it?

Present ability to pay is not determined, but the opinions indicate that both Courts below believed the District could pay more than it offers (R. 176, 1059).

4. Is it *res judicata*, as we contend, that the relief here sought cannot be granted? An earlier proceeding under the first Municipal Bankruptcy Act between these parties presented the identical plan now presented for confirmation. After the decision of *Ashton v. Cameron County Water Improvement District No. 1*, 298 U. S. 513, these petitioners moved to reverse the judgment on the authority of that decision, which motion was granted. We submit that the identical right now asserted by the District was adjudicated upon in the prior proceeding. The Courts below held the contrary.

5. The R. F. C. loan contract exacted a pledge of the District's power revenue as security for its loan. Does this circumstance place the R. F. C. in a different class of creditors from the objecting bondholders, as we contend, so as to make it improper to count the R. F. C.'s consent against them? No bondholder, other than the R. F. C., consented to the plan.

6. Was it proper to count the R. F. C.'s consent against the objecting bondholders, considering that the R. F. C. is satisfied with the plan because the plan gives it all that it is entitled to in any event, and considering that any modification of the plan in favor of the objecting bondholders would be undesirable from the point of view of the R. F. C.?

7. Is the entire amount of the bonds held by the R. F. C. owing by the District, or are they simply held by the R. F. C. as security for its loan of less than half the amount otherwise due thereon, as we contend?

8. Is a plan fair which (as here) coerces consent by informing the creditor that if he questions the offer he will not receive any interest on the amount offered, during such number of years it may take to litigate the fairness of the offer in question?

It should be observed that the plan contemplated payment by the District of 4% interest on the aggregate amount of the offer, because the plan contemplated the borrowing of the aggregate amount offered from the R. F. C. at 4%, and something over 80% of it was, in fact, so borrowed, and paid to consenting bondholders, in 1935.

9. Does a proceeding under a state reorganization statute, pending when this action was commenced and still pending, designed to effectuate the identical plan here involved, oust the federal courts of jurisdiction?

10. Does the bankruptcy act confer jurisdiction of this proceeding, considering that the Supreme Court of California has recently held that the functions of irrigation districts are exclusively governmental?

**REASONS FOR ALLOWANCE OF THE WRIT.**

(1) We respectfully submit that this Court should settle the meaning of the requirement, in the municipal bankruptcy provisions, that the plan shall be "fair, equitable and for the best interests of the creditors".

(a) The situation is not identical with the situation presented by the provisions of Chapter X, disposed of by this Court in *Case v. Los Angeles Lumber Products Co.*, 308 U. S. 106.

(b) The opinions below disclosed the fact that term "fair and equitable" was taken merely in its popular sense; and the conclusion is an unanalyzed, and, to a degree, inarticulate, judicial reaction to the mass of evidence as a whole. The courts take no account of (and made no findings concerning) the value of the District's corporate properties, or the value of the privately owned lands charged with the bonds, or the past income of the District as evidence of ability to pay, or the potential ability of the District to pay, whether present or future.

(c) So far as the conclusion reached below (that the plan is fair) is based on formulated premises, it is rested on improper grounds, namely the following:

1. That some relief was necessary in 1933 (five years before this action was commenced) (R. 174, 1058);

2. That the surrender to the R. F. C. of 80 per cent of the bonds in 1935 greatly relieved the District's situation (R. 175, 1059);

3. That the District's present ability to pay (not determined) is largely the result of the R. F. C. loan and the surrender of bonds thereunder (R. 176, 178, 1059);

4. That the proportion of bonds surrendered (largely in 1935) is irrefutable evidence that the plan is fair (R. 176);

5. That no modification of the plan is feasible because the court should not disturb the R. F. C.'s contract, and cannot alter it (R. 178);

6. That but for the plan, the bonds would be worth less than is offered by the plan (R. 176, 1059-60).

(2) This Court should determine, we submit, that a State seeking bankruptcy relief must provide means for effectuating the statutory requirement that the plan be fair.

The municipal bankruptcy provisions are described by this Court as providing for cooperation between State and Nation.

*United States v. Bekins*, 304 U. S. 27, 53, 54.

The statute requires plans to be fair, equitable and for the best interest of creditors.

We submit that the State's part of the cooperative venture includes the duty of providing means for effectuating the requirement of fairness.

The opinions below show, we submit, that the plan was confirmed on the assumption (erroneous, we believe), that unless existing California statutes provide means for giving creditors the benefit of the District's property and income, this plan may be confirmed even though the court believes (a) that the District's corporate properties, and the private property charged with the bonds, each exceeds the total debts sought to be scaled down, and (b) that the District's average income is sufficient to pay far more than is offered by the plan.

It should not be held, we submit, that a State may demand and receive approval of a plan cutting debts in half on the ground that although the debtor could pay much more, the State has not provided means for enabling it to do so.

(3) The statute here involved provides (Sec. 82) that any agency of the United States holding securities under contract with any petitioner shall "be deemed a creditor in the amount of the full face value thereof". Here (as in doubtless other cases), although the R. F. C.'s contract rights are only those of a pledgee (as we submit), and although its status as such was fixed years before the statute was passed, nevertheless it is held below that the District is to be treated as owing the entire amount of the bonds pledged for a debt less than half the amount of the bonds.

We submit that the meaning of this provision should be determined by this Court.



(4) Section 83(j) of the statute was enacted after this proceeding was commenced. It is nevertheless held below to have changed the substantive relation between the R. F. C. and the District, as well as the rights of these petitioners.

We submit that if this statute is to be treated as thus retrospective, that fact should be determined by this Court.

(5) This plan (as doubtless many others) proposes that the District borrow money at 4% to discharge its debts (for less than half the amount due) in cash. The objecting bondholders have been litigating the fairness of the plan for years. The plan and the decree nevertheless propose to pay them the amount of the original cash offer without any interest. We submit that such a plan is unfair and that this Court should so determine.

(6) Prior to the enactment of the statute upon which this proceeding rests, an action was commenced by the District against these petitioners under a state refinancing statute seeking the identical relief which is sought here. In this proceeding we pleaded that action in bar.

We know of no decision of this Court determining the effect of the passage of a new bankruptcy act upon pending state proceedings under state laws. We submit that the question should be settled.

WHEREFORE, Petitioners pray that a Writ of Certiorari be issued out of and under the seal of this Hon-

orable Court, directed to the United States Circuit Court of Appeals for the Ninth Circuit, commanding that Court to certify and to send to this Court for its review and determination a full and complete transcript of the record and of the proceedings of said Court in the case numbered and entitled in its dockets as "No. 9242, West Coast Life Insurance Company, a corporation, Pacific National Bank of San Francisco, a national banking association, et al., Appellants, v. Merced Irrigation District, Appellee", and that the decree of said Court be reversed by this Court with directions to dismiss the bill, and for such other relief as to this Court may seem proper.

Dated, San Francisco, California,  
November 18, 1940.

Pacific National Bank of San Francisco, a  
national banking association,

Mary E. Morris,

R. D. Crowell,

Belle Crowell,

Minnie E. Rigby as Executrix and Richard tum

Suden as Executor of the Last Will of William

A. Lieber, Alias, Deceased,

Milo W. Bekins and Reed J. Bekins as trustees  
appointed by the Will of Martin Bekins, de-  
ceased,

Milo W. Bekins and Reed J. Bekins as trustees  
appointed by the Will of Katherine Bekins,  
deceased,

Reed J. Bekins,

Cooley Butler,

Chas. D. Bates,  
 Lucretia B. Bates,  
 Edna Bicknell Bagg,  
 John D. Bicknell Bagg,  
 Mary B. Cates,  
 Nancy Bagg Eastman,  
 Charles C. Bagg,  
 Horace B. Cates,  
 Barker T. Cates,  
 Mary Edna Cates Rose,  
 Mildred C. Stephens,  
 N. O. Bowman,  
 W. H. Heller,  
 Fannie M. Dole,  
 James Irvine,  
 J. C. Titus,  
 Sam J. Eva, William F. Booth, Jr., George N.  
 Keyston, George W. Pracy, H. T. Harper and  
 George B. Miller as trustees of Cogswell Poly-  
 technical College,  
 Tulocay Cemetery Association, a corporation,  
 Percy Griffin,  
 Emogene Cowles Griffin,  
 D. Lyle Ghirardelli,  
 A. M. Kidd,  
 Grayson Dutton,  
 Stephen H. Chapman,  
 Edith O. Evans,  
 J. Ofelth,  
 Dante Muscio,  
 I. M. Green,  
 Julia Sunderland,  
 Lily Sunderland,  
 Florence S. Ray,  
 Joseph S. Ray,

Amelia Kingsbaker,  
 S. Lachman Company, a corporation,  
 Sue Lachman,  
 Sophia Mackenzie,  
 Nettie Mackenzie,  
 R. J. McMullen,  
 J. R. Mason,  
 Gilbert Moody,  
 William Payne,  
 G. H. Pearsall,  
 Sherman Stevens,  
 E. G. Soule,  
 Margaret B. Thomas,  
 Isabella Gillett and Effie Gillett Newton as execu-  
 trices of the Estate of J. N. Gillett, deceased.  
 Theo. F. Theime,  
 Fletcher G. Flaherty,  
 Frances V. Wheeler,  
 Miriam H. Parker,  
 Apphia Vance Morgan,  
 First National Bank of Pomona,  
 George F. Covell,  
 Alma H. Woore,  
 George Habenicht,  
 Seth R. Talcott,  
 Adolf Aspegren,  
 J. H. Fine,  
 Mrs. J. H. Fine,  
 F. F. G. Harper,  
 W. S. Jewell,  
 Florence Moore,  
 American Trust Company as trustee under a cer-  
 tain agreement between R. S. Moore and Amer-  
 ican Trust Company dated December 15, 1927,

Crocker First National Bank as trustee under a certain agreement between Florence Moore and Crocker First Federal Trust Company, dated December 15, 1937.

HERMAN PHLEGER,

PETER TUM SUDEN,

W. COBURN COOK,

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LUCIUS F. CHASE,

DAVID FRIDENRICH,

BROBECK, PHLEGER & HARRISON,

*Of Counsel.*

# In the Supreme Court

OF THE  
United States

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OCTOBER TERM, 1940

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No.

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PACIFIC NATIONAL BANK OF SAN FRANCISCO,  
a national banking association, et al.,  
*Petitioners,*

vs.

MERCED IRRIGATION DISTRICT,

*Respondent.*

## BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

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### I. FACTUAL BACKGROUND OF THE CASE.

A brief history of Merced Irrigation District up to 1929 appears in Exhibit OO, pages 118-139.<sup>1</sup>

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<sup>1</sup>Exhibit "OO" is the transcript of record presented to this Court in the previous action between these parties (under the first Municipal Bankruptcy Act), entitled "Merced Irrigation District, The Reconstruction Finance Corporation, et al., Petitioners, v. Reed J. Bekins and Milo W. Bekins, et al., Respondents", No. 206. This record, consisting of one volume, is (by stipulation and with the approval of the Clerk of this Court) treated as a part of the record in the present proceeding.

The respondent, Merced Irrigation District, was organized late in 1919 (Ex. OO, p. 118).

Considered geographically, the District contains over 189,000 acres, being "The fifth largest district in California, and one of the most important" (Ex. OO, p. 119).

The original estimate in 1921 of the cost of buying and constructing the works of the District was \$15,850,000 (Ex. OO, p. 121). Ultimately it was found necessary to issue bonds for a total of \$16,250,000 (Ex. OO, pp. 121, 123).

The District purchased the properties of a private water company operating in the District (irrigating a maximum of 40,000 acres), and constructed the Exchequer dam in Merced River, a hydro-electric plant, and an extended irrigation system. The Exchequer dam is one of the largest in the country, and when completed in 1926, was said to be the highest dam in the world (Ex. OO, p. 128; R. 682).

The power plant was completed late in 1926 and has been in full operation ever since. The District sells its power to a private water company under a contract to expire in 1964, and has received for its power an average of \$445,000 per year up through the year 1938. The revenue derived from power depends on the amount of power produced, and the amount produced depends in turn on rainfall. The period of operation so far, includes the lowest average rainfall of any consecutive nine-year period from 1870 to date (R. 535).

The District met all payments of principal and interest on its bonds up to and including payments due January 1, 1933. It has paid nothing since, except some interest to bondholders who surrendered their bonds, and interest paid to the R. F. C. on its loan.

In March, 1932, a Bondholders' Committee was formed, to deal with anticipated default of the District, due to extremely low agricultural prices and low returns during the previous three years from the sale of power because of an unprecedented drought (R. 940).

The chairman of the Bondholders' Committee, from its creation in 1932 down to January, 1935, was a Mr. Keplinger who, though apparently not an officer of the Bank of America, represented its interests on the Committee (R. 506). At the time when the plan here involved (then a voluntary plan) was approved late in 1935, the chairman of the Committee was F. S. Stevenot, an officer and representative of the Bank of America (R. 504).

The Bank of America was not only a bondholder (R. 885, 504), but also owned something over 3,000 acres of land in the District through its subsidiary, Cal. Lands, Inc. (R. 472-3); and was also heavily involved in the District by virtue of holding many mortgages on lands in the District, securing, in the aggregate, a large amount of loans (R. 421, 503; Ex. OO, p. 75).

Immediately upon its creation, the Committee solicited the deposit of bonds under a deposit agree-



ment (R. 576), and a major portion of the bonds was deposited. Mr. Keplinger, as chairman of the Committee, went to Professor Murray R. Benedict, an agricultural economist in the Giannini Foundation at the University of California, and asked him to prepare a report on the condition of the District (Ex. OO, p. 75). Mr. Benedict and others working under his supervision prepared what is herein referred to as the "Benedict Report", which is Volume 4 of the record herein, and is the principal basis of the District Court's contention concerning the fairness of the plan.

On the basis of this report the Bondholders' Committee submitted a plan to the bondholders providing for payment of the entire amount of bond principal, with extensions of maturities and some reduction in interest (R. 576, Ex. OO, p. 91). This plan was approved by the electors in the District (Ex. OO, p. 91); but after the enactment of Section 36 of the Emergency Farm Mortgage Act, providing for R. F. C. loans, the District applied to the R. F. C. (December 16, 1933, R. 600) for such a loan. In November, 1934, the R. F. C. granted a loan of \$8,600,000, calculated to pay the bondholders 51.501¢ on the dollar on principal, and nothing for interest in default. The terms of this loan are identical with the terms of the plan here involved.

Whether or not the R. F. C. made an appraisal of the District, and if it did what that appraisal showed, does not appear in the record. Presumably, the R. F. C. followed the statute (43 U. S. C., Sec. 403), which

requires R. F. C. to cause "an appraisal to be made of the property securing and/or underlying the outstanding bonds of the applicant," and which provides that before making such a loan the R. F. C. must be satisfied that the borrower will be able to acquire "a major portion" of its bonds at "the average market price of such bonds over the six months period ending March 1, 1933". Merced bonds had been selling at extremely low figures during this time.

A proposal embodying the terms of the R. F. C. loan was then formulated, and the Bondholders' Committee (which at this time represented over 80% of the bondholders) then sent them a questionnaire, on January 7, 1935 (R. 958) asking whether they desired the so-called "Cash Offer plan, i. e., the plan now before the Court, offering 51.501¢ on the dollar of principal, and nothing for defaulted interest, or the former plan calling for extensions of time, reduction of interest and ultimate payment of the full amount of principal.

In submitting these alternatives to the bondholders, the Committee stated that it thought the cash offer "unduly low", and that whether they should accept it depended upon "the circumstances of the individual bondholders" (R. 496, 498). The majority replied expressing preference for the cash offer plan, which the Committee thereupon voted to accept by a vote of 8 to 5 (R. 501).

Several large bondholders, in addition to the Bank of America, were represented on the Bondholders' Committee, including several of your petitioners

herein. All of these large bondholders, except the Bank of America, withdrew their bonds after the Committee's approval of the cash offer plan (R. 885, 504). Over \$14,000,000 in principal amount of bonds were surrendered pursuant to this plan, the former holders accepting 51.501¢ on the dollar in full and final satisfaction of their claims (R. 344).

At that time there were 1200 bondholders, holding an average of \$13,500 of bonds each (R. 503).

The first Municipal Bankruptcy Act was passed in 1934, and on April 19, 1935, the District filed a petition under that statute setting forth the cash offer plan (Ex. OO, p. 41). The Bondholders' Committee consented to the plan pursuant to authority in the deposit agreement (R. 584, 593).

The District Court confirmed the plan by its decree of March 4, 1936. An appeal was then taken to the Circuit Court of Appeals. Pending the appeal this Court decided the case of *Ashton v. Cameron County Water Improvement District No. 1*, 298 U. S. 513, holding that the first Municipal Bankruptcy Act was void. Thereupon, on March 16, 1937, these petitioners moved the Circuit Court of Appeals to dispense with the printing of the record and for a judgment of reversal, on the authority of the *Ashton* case (Ex. OO, p. 333). Pursuant to the motion, the Circuit Court of Appeals reversed the decree of the District Court on April 12, 1937, with directions to dismiss (R. 106, 90 Fed. (2d) 1002); and in due course this Court, on October 11, 1937, denied the District's petition for a writ of certiorari (302 U. S. 709). Thereafter, on July 6,

1937, pursuant to mandate (R. 962) the District Court entered its decree of dismissal (R. 965).

In the meantime, the present Municipal Bankruptcy Act had been passed, on August 16, 1937, as Chapter X of the Bankruptcy Act (50 Stat. 654, 11 U. S. C., Secs. 401-404). It is now Chapter IX of the Bankruptcy Act as amended by the 75th Congress, 3rd Session (52 Stat. 840, 939-40).

This new act was upheld in *United States v. Bekins*, 304 U. S. 27, decided April 25, 1938. On June 17, 1938, the present proceeding was commenced under the new statute, seeking confirmation of the identical plan confirmation of which had been sought in the previous proceeding (R. 8, 36; Ex. OO, p. 10).

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## II. THE PLAN IS UNFAIR BY ANY STANDARD.

In this and in the next Section, we discuss, (a) the amount of the District's debts, (b) the value of its corporate assets, (c) the value of the privately owned lands in the District charged with payment of the bonds, and (d) the District's past, and probable future, income.

The evidence concerning these matters is not exhaustive; and in that connection we call attention to the following propositions:

(a) The trial court has made no finding whatever concerning any of these matters, nor did the court below;

(b) The burden of proof was upon the District to show the plan was fair and equitable, and

in that behalf to show what the facts were concerning the matters above enumerated;

(c) Particularly in the light of the foregoing, we submit that under the rule of *First National Bank v. Flershem*, 290 U. S. 504, 525, and similar cases, the evidence now to be discussed should be considered by this Court unless it intends to grant a new trial.

**(a) The District's debts.**

The District's total debts on November 1, 1938 (they are not shown as of June 17, 1938, the date action was commenced), amounted to a total of \$21,252,-256.47. This includes all debts, whether affected by the plan or not (Ex. Z, R. 886-7). This amount is \$1,509,366.26 less than the amount of the District's debts shown on its balance sheet of the same day, that is, of November 1, 1938 (Ex. 26, R. 669). The difference is accounted for by inaccuracies in the District's balance sheet which are corrected by Exhibit Z, as follows (see testimony of the District's Auditor, R. 425-6, 520):

(1) The District's balance sheet states, as owing, the entire amount of the District's unpaid bonds (both matured and unmatured), and as a separate and additional item of debt, states the amount of matured unpaid bonds, amounting to \$387,000.00;

(2) In the item of unpaid matured bond interest coupons, the balance sheet includes interest which had actually been paid to depositing bondholders and to the R. F. C. It also includes interest on these two items

of interest which had already been paid. These inaccuracies are shown by, and corrected in, Exhibit Z.

**(b) The District's corporate assets.**

The District's assets as of the date of the commencement of the action do not appear. They are shown as of a few months later, in the District's financial statement as of November 1, 1938 (Ex. 26, R. 669), which shows the following:

Cash .....	\$ 1,578,446.14
Other current assets .....	250,661.92
Net capital assets (physical prop- erties) .....	18,649,793.20

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Total .....	\$20,478,901.26
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The total should be shown as.....	\$21,318,901.26
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The difference between the two amounts consists of an additional item which the District's Secretary admitted must be added to the capital assets shown in the balance sheet (R. 515). This item consists of the aggregate of water rights purchased from customers of the water company which formerly operated in the area, which rights were purchased for a total price of \$1,020,000. Of this sum, \$840,000 has been paid (R. 510-12, 515). Adding this item to the other assets gives total net assets of \$21,318,901.26.

The physical properties included in the balance sheet are valued therein at cost less depreciation (R. 424). There is no evidence in the record of the value of the physical properties other than this evidence, namely, cost less depreciation. In these circumstances, and in

view of the District's burden of proving insolvency, we submit that the minimum value to be given to the District's physical properties (primarily its dam, power plant and irrigation system) is the amount thus shown by the District's books, namely, cost less depreciation. The minimum total of the District's physical properties and other assets is therefore \$21,318,901.26.

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### **III. THE DISTRICT'S INCOME IS SUFFICIENT TO PAY A DEBT APPROXIMATELY TWICE THE AMOUNT OFFERED BY THE PLAN.**

We now summarize very briefly the evidence of the District's income from each major source. We shall then compute what its aggregate income shows on the subject of ability to pay.

#### **(a) The District's past income from assessments.**

The District was organized in December, 1919. Its income from assessments is shown from the beginning. Its income from the sale of power is shown from the beginning of such sales in 1926. Its income from other sources is shown since 1931, but is not shown for the years preceding 1931. The evidence of income stops shortly after the end of the fiscal year 1937-38. From 1920 to 1933, both inclusive, the District levied assessments designed (with its other revenue) to meet its obligations. For the following five years shown in the record the assessments levied were much less in amount, and still are, for two reasons:

**Case No. 591, 1940.**

**Correction to Brief in Support of Petition for Writ of Certiorari.**

Page 35, lines 19 to 23 should read as follows:

“gations. As a result, the District’s cash on hand rose from \$183,180.46 on December 31, 1933 to \$1,578,446.14 on November 1, 1938 (R. 669, 845), the latest date shown; and this notwithstanding the extremely low levies during this period.”





(1) Beginning with the levy of 1933-34 and down to the present time the District has operated under Section 11 of the Districts' Securities Commission Act (Cal. Stats. 1931, p. 2263, as amended by Cal. Stats. 1933, p. 355 and as since amended). This is a moratorium statute, relieving districts which have got into difficulties from the necessity of levying assessments sufficient to meet their obligations, and authorizing them, with the approval of the California Districts Securities Commission, to "levy only for such total amount as in their judgment . . . approved by the Commission it will be reasonably possible for the lands in said district, taken as a whole, to pay without exceeding a delinquency of fifteen per cent".

(2) The consummation of the R. F. C. loan, and the surrender pursuant thereto (in 1935) of more than 80 per cent of the District's bonds, materially reduced the amounts necessary to meet current obligations. As a result, the District's cash on hand rose from \$188,180.46 on December 31, 1933 to \$1,829,106.06 on November 1, 1938 (R. 669, 701), the latest date shown; and this notwithstanding the extremely low levies during this period.

The annual levy prior to the year 1928-29 does not appear for each year, though the total appears. The average annual levy from 1928-29 through 1932-33 exceeded \$1,100,000. The average annual levy from 1933-34 through 1937-38 averaged only about \$270,000.

More important than the amount levied, in determining ability to pay, is the amount actually paid by the landowners to the District. During the first twelve

years, i. e., up through the year 1932, the landowners actually paid to the District a total of \$10,402,666.69 in assessments, or an average of \$866,888.39 per annum. This amount, taken with the District's other income, is sufficient, after paying operating expenses, to amortize in thirty-five years, at 4% (the term of the refunding bonds proposed by the plan) more than twice the amount offered by the plan.

If we take the entire eighteen years of the District's life shown in the record, including the early formative years, some very good years that followed, and the very bad years of the depression, the landowners have actually paid, in assessments, an average of \$700,421 a year (R. 705, 667).

If we take the last seven years given in the record (1931-37), starting with, and including the whole of, the great depression, we find that the landowners actually paid, in assessments during those seven years, an average of \$517,850 per year (R. 829, 837, 846, 853, 863, 873, 881).

And these seven years were far below normal in farm income. Farm prices during this seven-year period (although they have increased steadily every year since 1931, R. 734), were so unprecedentedly low in 1931, 1932 and 1933 as to make the average for the seven years only 86% of the period 1909-14, taken by the federal authorities as normal (R. 733-4).

Moreover, the District has not even pretended to levy anything for bond service during  $5\frac{1}{2}$  of those seven years, the rate being from \$3 per \$100 down to \$1 per \$100 of assessed value (R. 667).

In the year 1932, when agricultural prices fell to their lowest point (44% of the 1909-14 average, R. 734), and when the District levied the highest rate in its history, resulting in a 62% delinquency, the land-owners actually paid, in assessments, \$578,110.38 (R. 837).

**(b) The District's power revenue.**

It cannot reasonably be contended that the District's revenue from power will average less than \$500,000 per year.

1. Two careful and exhaustive studies by recognized authorities were made (R. 890-948, 524-38). One is based on the run-off of the Merced River from 1902 to 1938, both inclusive, and shows an average revenue under the District's present power sale contract (which runs until 1964), of \$511,651 per year (R. 937). The other study, which carried the computation back to 1871 shows average revenue of \$534,000 per year (R. 534).

2. The District itself reported to the R. F. C. that it is reasonable to assume that its future power revenue will average between \$500,000 and \$621,000 per year (Ex. OO, pp. 103-105).

3. Figures supplied by the District to the Districts Securities Commission, estimated in 1936 that the power revenue for 1937 would be \$500,000 (R. 728); and estimated in 1937 that the power revenue for 1938 would be \$500,000 (R. 783). The amount actually received in each of these years was more than \$500,000 (R. 937).

The only evidence the other way consists of the fact that during the period of actual operation, 1926-38, which includes the lowest consecutive nine years of run-off since 1871 (1926-34, R. 937, 535), the average power revenue was only \$445,000 (R. 933, 937).

It is plain, we submit, that in determining probable ability to pay, the District's power revenue cannot fairly be taken as less than an average of \$500,000 per year.

**(c) The District's revenue from miscellaneous sources.**

During recent years the District's revenue from miscellaneous sources (land rentals, water tolls, interest, and miscellaneous revenue) has averaged about \$80,000 a year (R. 863, 873, 881).

**(d) The District's operating expenses.**

The only testimony concerning operating expenses is that of the secretary of the District, who testified, in the former bankruptcy proceeding, that annual operating expenses would amount to a total of \$400,000, excluding payments on certain drainage bonds now fully paid, and payments on Crocker-Huffman contracts which will be fully paid next year (Ex. OO, p. 63; R. 694-5). In this proceeding he raised this to \$500,000, explaining the difference by additional proposed capital improvements of \$30,000 per year, and some increase in labor costs (R. 515). This figure includes drainage bond payments and Crocker-Huffman payments, amounting to about \$50,000 per year

(R. 874, 883), both of which will have ceased entirely next year (R. 694-5).

The testimony is not directly contradicted, for the bondholders have no means of doing so; but it is contradicted by the undeniable fact that the District's actual operating expenses averaged only \$401,134.43 (R. 864-5, 873-5, 881-3), for the last three years shown in the record notwithstanding the fact that during these years the District had a very large surplus of cash on hand (Ex. X, R. 827, 862, 876, 880), and had no reason, therefore, to defer proper expenditures.

Moreover, the secretary's estimate of operating expenses includes \$125,000 per year for capital improvements, which we submit cannot be considered in determining the ability of the District to pay its debts.

The District's own estimated operating expenses (including capital improvements), for 1938, reported to the R. F. C., were less than \$425,000 after eliminating payments on drainage district bonds which the District took over and which are now all paid, payments on Crocker-Huffman contracts which will all be paid off next year, and refinancing expenses (R. 774, 783, 694-5).

**(e) The District's net income as  
indicating ability to pay.**

The plan proposes a 4% bond issue with maturities running from 1941 to 1975 (R. 202, 204). Taking this plan as a standard, it is a simple matter of computation from the foregoing figures concerning the District's past and probable future income, to show that even taking the most pessimistic view, it would

be impossible reasonably to conclude, on the basis of past experience, that the District cannot pay a great deal more than its plan offers.

The last seven years, shown in the record (1932-1937), is the worst available sample upon which to base an estimate of future income, primarily for two reasons:

(1) During five of those seven years, the total assessments levied were much less than half of what the bondholders have actually paid on the average during the District's entire existence (R. 667).

(2) This seven year period includes the worst of an unprecedented depression in agricultural prices, now past (R. 733).

Notwithstanding this, the fact is that the average annual amount of assessments actually paid to the District during that seven year period was \$517,850, as shown above. And if we assume that future power revenue will be only \$450,000 (which is plainly too low), and assume that future operating expenses will be \$450,000 (which is plainly too high), the income of the District will be sufficient to discharge a debt of \$11,209,687 at 4% in thirty-five years, namely, \$2,869,687 more than the plan proposes to pay, i. e., \$8,338,011.

In the light of all the foregoing, it is plain that any reasonable estimate of future income, based on past experience, calls for the conclusion that the District's income will be sufficient to discharge (at 4%, in thirty-five years), a debt at least twice the amount which the plan proposes to pay on those terms.

**(f) The District's evidence concerning ability to pay.**

The District, as well as both courts below, relied for showing that the plan is fair upon the so-called "Benedict Report" (Ex. 35, R. Vol. IV), the testimony of its principal author (at the former trial, in February, 1936), Dr. Murray R. Benedict (R. 432-472), and testimony of Mr. Gustave Momberg (R. 472-494), which was offered at the present trial, as "bringing down to date" the evidence already mentioned.

The Benedict Report deals with the income from farming operations in the District during the years 1929, 1930 and 1931, and contains a supplemental study of the income from a small group of farms in the preceding three years, i. e., 1926-28. Dr. Benedict's testimony was read into the record at the trial of the present proceeding (in November, 1938), failure to produce the witness being waived, but over the objection that the evidence was too remote (R. 432). We cannot here examine this evidence exhaustively, and must content ourselves with a few remarks concerning it:

1. At the time covered by the Benedict Report (which ended seven years prior to the trial of this proceeding), the District, as the Report itself admits (p. 70), was still in the stage of development, and had not been adjusted to the changed conditions arising out of the construction of the irrigation system. The period covered was a panic period, admittedly not typical (R. 451).



2. Since the period covered by the Report, many substantial changes have occurred. Dr. Benedict, testifying at the former trial in April, 1936, agreed that costs of production had declined (R. 471). The agricultural price index which stood at 87 in 1931 (the last year covered by the Report), was at 121 in 1937 (R. 734).

3. The body of the Report is a compilation of the data supplied by the individual and corporate operators of 150 farms in the District, which contains altogether some 2800 farms (R. 470). The 150 farms were drawn by lot from a list of the farms in the District of 20 acres or over, the smaller farms not being sampled at all (R. 470). It is admitted that the data supplied by the farmers was probably biased (R. Vol. IV, p. 24). Not all farms of 20 acres and over were included in the list from which the 150 farms were drawn, some being excluded for reasons that do not very clearly appear (R. Vol. IV, p. 103).

The exclusion from the list of farms sampled of all farms less than 20 acres in size (and others) had the effect that lands in the District representing 61% of the entire assessed value of all lands in the District were eliminated and not sampled at all, the sample being drawn from a group of farms representing 39% of the total assessed value (p. 103).

Figures given for the year 1931, but not given for the two previous years, show (p. 103) that in that year the total delinquency in payment of assessments for the entire District was 17.63%; that the delinquency for the lands from which the sample was taken was

43%, and the delinquency for the lands not sampled, totaling 61% of the entire assessed value in the District was only 1.4%.

The astonishing fact is, therefore, that the entire study represents an examination of a small sample drawn from a group of farms which in the aggregate defaulted 43.73% in the payment of assessments, while the study wholly ignores lands with a total assessed value of 61% of the entire District, which in the same year defaulted only 1.4%. These figures must be derived by calculation from the data given on page 103 of the Report, but the result of the computation given above is indisputable.

4. The data obtained from the farmers varied widely from general experience in the state. For example, the data concerning deciduous fruits (pp. 232-37) indicates low net returns for 1929; but in that year a study made of operations in the same general neighborhood (in Stanislaus County), based on actual and carefully kept records, showed a per acre net profit of \$467.50 (R. Vol. IV, p. 102).

5. The Report proceeded on the quite sound theory that due allowance should be made for family labor on farms so operated. But in arriving at the amount properly to be allowed for family labor, the Report achieved results inconsistent with the actual facts, as is now shown. It is rather difficult to follow any particular farm through the various tables in the Report because, although the farms are numbered (as "schedule" No. 244), they are arranged in each table

in a different order, and must be hunted out in order to be traced through the data given.

Space forbids detailed treatment of the matter, but we call attention, as an example, to the farm number 244 in Table 29 (p. 51), which showed a net loss for that farm of \$42.40 per acre for the year 1931. Table 27 (p. 49), showing labor charges, stated a total labor charge of \$105.00 per acre for this farm of which \$7.50 was hired and \$92.50 was family labor. Now there are a number of farms shown in Table 27 raising the same crops as farm number 244 but where all of the labor was hired, and the largest sum paid on any such farm where all of the labor was hired was \$39.51 per acre (farm number 320, Table 27, p. 51). If the labor charge on farm number 244 is reduced correspondingly, the showing of a loss of \$42.40 per acre becomes a profit of \$23 per acre. Similar discrepancies could be shown almost indefinitely. From the foregoing we submit that the data contained in this Report (which deals with the period ending seven years before the present proceeding) is at best very slight evidence of present ability to pay.

**(g) The testimony of the witness**

**Momberg.**

Mr. Momberg's testimony was submitted by the District as "bringing down to date" the Benedict Report.

Mr. Momberg is an employee of California Lands, Inc., a Bank of America subsidiary, and testified only concerning lands which were taken over by fore-

closure by the Bank of America and affiliates. It is admitted that this type of operation is very inefficient (R. Vol. IV, p. 64). Notwithstanding this fact, Mr. Momberg's testimony revealed the fact that the lands operated by him made a net profit over all costs of operation and after payment of assessments during every year of the period concerning which he testified, 1935-38 (R. 481-484, 488).

He testified, moreover, that the District's assessments constituted only five or six per cent of the total operating costs of the farms (R. 494). It is, we submit, apparent even from the foregoing very limited analysis that the District's evidence of ability to pay is of no substantial weight in the present proceeding, and certainly does not in any way impair the force of the evidence furnished by the District's actual experience, which is dealt with in some detail above. It shows that during the entire life of the District the landowners have actually paid assessments sufficient (together with the District's other income) to discharge a debt far greater than the amount offered by the plan.

**(h) The market value of the lands  
charged with payment of the  
bonds.**

It is well known that the market value of property is determined in large measure by its income producing capacity. For this reason it is important to determine the market value of the privately owned lands in the District, chargeable with its debts,

both because that value is directly relevant to the fairness of the plan and because that value is evidence of the extent of the District's ability to pay so far as dependent upon the collection of assessments.

The evidence consists of several items:

(1) As to rural lands, the District itself stated in 1934 that:

"The average assessed valuation per acre of land for ad valorem tax purposes in the County of Merced is \$30.00 per acre. This assessment is about 30 per cent of its market value." (Ex. OO, p. 103.)

This gives a total market value for rural lands in 1934 of over \$17,000,000.

(2) The latest figures shown concerning county assessments show an assessed value for rural lands in the District of \$12,941,420, and for land in cities and towns in the District of \$8,887,583 (R. 719). The California State Board of Equalization, dealing with figures over a period of years (1929-36), states that the ratio of assessed value (for ad valorem tax purposes) to actual value in Merced County varies between 26% and 35% (R. 959-961). Taking the highest ratio, 35%, the actual value in 1936 in the Merced Irrigation District was, for rural lands, just under \$37,000,000, and for urban lands \$25,393,000, giving a total in excess of \$62,000,000 for all lands in the District, urban and rural. Between 1934 and 1937 general conditions improved, and agricultural prices rose over 75 per cent (R. 734).

(3) Turning now to the assessment rolls of the District itself, the latest assessment roll of the District, shown in the record, values the privately owned lands (as of 1937-38) at \$11,468,155, which does not include lands deeded to the District for failure to pay assessments (R. 667).

In 1930-31, the District's assessment roll valued the same lands at over \$20,000,000 (R. 667). This was reduced by more than \$1,000,000 in 1931-32, and was further reduced by more than \$6,000,000 in 1932-33. The reasons for this action do not appear other than the fact that negotiations for scaling down the District's debts had begun in 1932, as shown above.

It is significant that improvements (including permanent crops, such as fruit trees, alfalfa, vines, etc., R. 425), are wholly ignored in the assessments made by the District. These improvements, however, are, of course, a part of the security for the bonds. They are ignored in the District's assessments in order to apportion a fair share of taxes to lands allowed to lie idle.

(4) Mr. Momberg (whose testimony was produced by the District allegedly to bring the "Benedict Report", which dealt with the period ending in 1931, down to date) testified that he was the manager of 58 ranches in the District containing a total of 3688 acres, owned by a Bank of America corporation, California Lands, Inc.; that these ranches are scattered all over the District, and raise substantially all the crops grown therein; that the quality of these lands represents a fair average of all the lands in the Dis-

trict; that the lands managed by him are held for sale at an average price of \$135 per acre; that this sales price was determined by determining what amount the lands can pay from earnings so as to pay interest on the sale price, and also pay all of their taxes, including District assessments (R. 473, 474, 489, 492, 494).

These figures give a total market value, at the time of trial, of the agricultural lands alone, in excess of \$23,000,000.

This value of \$23,000,000, it is to be observed, is the value of the lands over and above the encumbrance of the District's bonds.

We submit on the basis of the foregoing, speaking of agricultural lands alone, that the market value of the lands shows that in the opinion of buyers and sellers, these lands have an income producing capacity sufficient to amortize their share of the District's debt and still leave a value of \$23,000,000.

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#### IV. THE MEANING OF "FAIR AND EQUITABLE" IN THIS STATUTE.

- (a) States seeking bankruptcy relief must provide means for effectuating the requirement that the plan be fair.

In Part V of this brief (headed "Available means for effectuating the requirement of fairness"), it is shown, we submit, that existing California laws pro-

vide adequate means for the carrying out of a plan which will comply with the statutory requirement that the plan be fair, equitable and for the best interest of creditors. The point we now make is this:

In *United States v. Bekins*, 304 U. S. 27, 53, 54, this Court described the municipal bankruptcy provisions as providing for cooperation between State and Nation. The statute requires plans to be fair, equitable and for the best interest of creditors.

We submit that the State's part of the cooperative venture includes the duty of providing means for effectuating the requirement of fairness.

The opinions below show, we submit, that the plan was confirmed on the assumption that unless existing California statutes provide means for giving creditors the benefit of the District's property and income, this plan may be confirmed even though the court believes that (a) the District's corporate properties, and the private property charged with the bonds, each exceeds the total debts sought to be scaled down, and (b) even though the Court believes that the District's average income is sufficient to pay far more than is offered by the plan.

It should not be held, we submit, that a State may demand and receive approval of a plan cutting debts in half on the ground that although the debtor could pay much more, the State has not provided means for enabling it to do so.



- (b) The courts below ignored the essential factors determining fairness.**

As shown in our petition, neither the findings nor either of the opinions arrive at any conclusion whatever as to:

(1) The value of the District's corporate properties, or

(2) The value of the privately owned lands of the District charged with payment of the bonds, or

(3) The past income of the District as evidencing ability to pay, or

(4) The potential ability of the District to pay, whether present or future.

We submit, therefore, that the decision should not stand unless this Court, upon examination of the evidence, should find that the ultimate facts support the conclusion of the law that the plan is fair, equitable and for the best interest of the creditors.

- (c) Both courts below rested their conclusion of fairness on improper grounds.**

It is shown in the petition that the Courts below (R. 168, 1015) rested their conclusion that the plan was fair on the following grounds:

(1) That some relief was necessary in 1933 (five years before this action was commenced, R. 174, 1058);

(2) That the surrender to the R. F. C. of 80 per cent of the bonds in 1935 greatly relieved the District's situation (R. 175, 1059);

(3) That the District's present ability to pay (not determined) is largely the result of the R. F. C. loan and the surrender of bonds thereunder (R. 176, 178, 1059);

(4) That the proportion of bonds surrendered (largely in 1935) is irrefutable evidence that the plan is fair (R. 176);

(5) That no modification of the plan is feasible because the Court should not disturb the R. F. C.'s contract, and cannot alter it (R. 178);

(6) That but for the plan, the bonds would be worth less than is offered by the plan (R. 176, 1059-60).

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#### **V. AVAILABLE MEANS FOR EFFECTUATING THE REQUIREMENT OF FAIRNESS.**

The simple rule of common honesty which this statute enacts by requiring that the plan be fair and equitable is that the Court should not approve a plan whereby the debtor, without surrendering any property, proposes to scale down its debts to less than the value of that property.

This rule is entirely feasible as applied to California irrigation districts. We now enumerate the alternative means whereby the rule can be given effect.

(1) Preliminarily we submit that the statute by requiring that the plan be fair and equitable says in substance that bankruptcy relief is tendered to taxing agencies with the proviso that such relief shall not be granted unless the District can and does propose a plan conforming to the requirement contained in the statute that it shall be fair and equitable within the established meaning of those words.

If the statute is properly so construed, the result in the present case is plainly that the present plan should not be approved.

If it is not approved and no acceptable plan is put forward, the result will be one of two things, both of which have occurred in other districts in California. See *Provident Land Corporation v. Zumwalt*, 12 Cal. (2d) 365, 373:

(a) Actually, the decree would not affect the present condition of the District, quite apart from the fact that the District is already actually refinanced by the R. F. C. loan, for the fact is that the District without doubt would continue to operate under Section 11 of the Districts Securities Commission Act (described above), which permits irrigation districts, which have in the past defaulted, to cease levying assessments for the payment of its debts as they mature and to levy assessments only in such amount as the lands in the District can reasonably pay. The Merced Irrigation District has, in fact, been operating under this statute since 1933 (R. 402, 403).

(b) The other possible alternative, if this plan was not confirmed and no acceptable plan was pro-

posed, would be that the District would levy assessments, take over such lands as defaulted after three years, and resell or rent these lands. This process is described in *Provident Land Corporation v. Zumwalt*, supra, which case also recites the fact that just this has occurred in several districts. The case also holds that all rents or other income received from lands taken over by the District are held by it in trust for the purposes of the Act, namely, for operating expenses and payment of its debts.

There is (we submit) no evidence in the record justifying the conclusion that this would occur even if the District commenced levying assessments sufficient to meet its debts, and even assuming that its debts are as much as it claims them to be.

(2) The second, and perhaps most obvious means for compliance of the California Irrigation Districts with the requirement that the plan be fair is that the District propose a plan for refunding its debt over a longer period than it proposes in fact.

We submit that there is no basis upon which it could be said that it is either fair, equitable or honest for this District to scale down its debts to less than half of their present amount, on the theory that it should pay only so much as it can comfortably pay during the next thirty-five years and should, having done so, be free from all obligation.

The first refunding plan proposed by the Bondholders' Committee, and approved by the electors of the District, proposed a fifty year bond issue (R. 736, 747-50).

(3) As suggested in the opinion of the trial Court (R. 175) and as stated by the Supreme Court of California in *Provident Land Corporation v. Zumwalt*, 12 Cal. (2d) 365, 371, the irrigation districts in California have got into difficulty because of the inexorable requirement that they levy assessments each year sufficient to meet current obligations plus all past defaults. As we have seen, this is no longer true. The point we now make is this:

Merced Irrigation District's difficulties arose out of the statutory requirement for pyramiding debts. The District is peculiarly susceptible to this difficulty because of the fact that its income is very variable. Its income varies not only with farm prices but with the water revenues which it receives.

As a consequence, it is, we submit, plain that a plan should be devised whereby the District's creditors could take advantage of the **average** of the District's fluctuating income. This could be done, and indeed was done, under the first refunding plan approved by the electors of the District by the issuance of callable sinking fund bonds maturing in fifty years (Ex. OO, p. 93). Such a plan would permit the District to make such payments in each particular year as its income justified, and would give its creditors the benefit of the average of its fluctuating income.

(4) Another alternative would be simply to continue doing what the District is doing now, namely, for the District to continue operating under the statute mentioned above, authorizing it, with the approval of the Districts Securities Commission, to levy such

assessments each year as its income for the coming year justified.

(5) The last major alternative is this: Under the California law an irrigation district may voluntarily dissolve, and turn its assets over to a private water company organized for the purpose.

The California Statutes of 1903, page 3, as amended, provide briefly as follows:

Section 1 provides that:

“Any irrigation district \* \* \* may be dissolved in the manner hereinafter provided \* \* \*”

Section 2 provides for a petition calling for such dissolution and reads in part as follows:

“Said petition shall also state the assets of said district, including irrigation system, if any, dams, reservoirs, canals, franchises, water rights, a detailed statement of all the lands sold to the district for assessments, and the amount of the assessments on each parcel of land sold, also all assessments unpaid, and the amount upon each lot or tract of land, and all other assets of the district; and in case any proposition has been made by the holders of said indebtedness to settle the same, said proposition, together with any plan proposed to carry the same into execution, shall be included in said petition.”

\* The proposal must be approved by the Superior Court of the State of California (Sec. 5).

Section 7 provides that a corporation may be organized for the purpose of acquiring the assets of the District. That section reads as follows:

“A corporation may be organized under general laws for the purpose of acquiring the assets of said district, including the irrigation system, if any, dams, reservoirs, canals, franchises and water rights, which corporation shall have all the powers, rights and franchises of corporate bodies organized under general laws, and in addition shall have such further powers as may be necessary to possess and carry on said irrigation system and exercise such franchise and water rights.”

Section 8 reads as follows:

“The court in its decree shall have power to make the orders necessary to carry out said proposition for the discharge of the indebtedness and distribution of the property of said district, including the right to apportion any indebtedness found due, and to declare said portions liens upon the various parcels and lots of land within the district, and may decree a sale of its assets in such manner as may effectuate said proposition and as the said court may judge best, either in one lot or in such parcels as may be provided, and may provide for conveyance of said irrigation system, including dams, reservoirs, canals, franchises and water rights, and also of any other assets of the district, including lands sold thereto and the assessments due it.”

If such a plan were carried out in the present case, the result would be that the bondholders would receive the operating properties of the District (which were paid for by the District with the proceeds of the bonds) and the District's properties would then be operated by the new corporation, owned by the bond-

holders as a public utility. This, because the California statutes provide that:

“Whenever any person, firm or private corporation \* \* \* sells, leases, rents or delivers water to any person, firm, private corporation, municipality or any other political subdivision of the state whatsoever \* \* \* such person, firm or private corporation is a public utility, and subject to the provisions of the public utilities act of this state and the jurisdiction, control and regulation of the railroad commission of the state of California;” (General Laws of California, p. 4265).

The corporations net power revenue alone would pay what the plan offers in 31 years (R. 933, 938).

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**VI. IT IS RES JUDICATA BETWEEN THESE PARTIES THAT JURISDICTION TO IMPAIR THE OBLIGATION OF THESE BONDS CANNOT CONSTITUTIONALLY BE CONFERRED UPON A FEDERAL COURT.**

In April, 1935, the District filed a petition under the first Municipal Bankruptcy Act (48 Stat. 798, 11 U. S. C., §§301-303), wherein the District sought confirmation of the identical plan here involved (R. 8; Ex. OO, p. 10). Substantially the same bondholders as are petitioners herein appeared in the proceeding as objecting bondholders (Ex. OO, pp. 42-43). The District Court confirmed the plan (Ex. OO, p. 275). Pending an appeal to the Circuit Court of Appeals, this Court decided that the statute was void, in *Ashton v. Cameron County Water Improvement District No. 1*, 298 U. S. 513.



Thereafter the objecting bondholders moved the Circuit Court of Appeals for a judgment reversing the decree of the trial Court with directions to dismiss. The motion was based on the ground that the proceeding rested on the statute, and that the statute had been held void in the *Ashton* case (Ex. 00, p. 333). The motion was granted (R. 106, 89 Fed. (2d) 1002). The District then petitioned this Court for a writ of certiorari (Ex. 00), which petition was denied October 11, 1937 (302 U. S. 709). Thereafter, on July 6, 1937, pursuant to mandate (R. 962), the District Court entered its decree dismissing the cause (R. 965).

After this Court had sustained the present Municipal Bankruptcy Sections (304 U. S. 27) the District, on June 17, 1938, commenced the present proceeding, seeking confirmation of the identical plan, confirmation of which had been sought in the earlier proceeding (R. 8, 36; Ex. 00, p. 10).

We submit that the previous decision between these parties concerning the District's right to confirmation of this plan, seeking to scale down these bonds, is *res judicata* of the rights of the parties.

Briefly stated, our argument is this:

(1) We submit that the substantive rights and powers created by the two statutes are, so far as here involved, identical. We submit further that it now appears from this Court's decisions, that the first statute was valid from the beginning. If this is true, then the second statute simply declared (but did not create) the rights and powers which had already been created by the first statute, and which were still, and are now, in existence.

If this is correct, then the right now asserted is the very right asserted, and held to be no right, in the previous proceeding between these parties.

(2) We submit that even though it were held that, although substantially identical, the second statute nevertheless "recreated" the rights conferred by the first statute (and thereby created a "new cause of action" in the District) nevertheless (we submit), it is settled that a rule of law, which has been announced and applied to a particular relation concerning particular property, is *res judicata* between the parties even though later found to be erroneous, and even though, in the second case, a new cause of action is asserted. See *Tait v. Western Md. Ry. Co.*, 289 U. S. 620, and cases there cited.

(3) We submit that even though this Court now holds that the first statute is void, and that the second is different from the first and valid, the previous judgment between these parties was an adjudication of the rights of the parties under the Constitution, apart from the statute: an adjudication that the Constitution confers upon these bonds and these petitioners immunity from having them scaled down by the federal bankruptcy court.

**(a) The first and second statutes  
are substantially indistin-  
guishable.**

We shall not analyze the two statutes in detail. Both are short, and both were recently considered. We respectfully submit that a mere reading of them

demonstrates that no substantial change in the first is made by the second.

**(b) This court did not hold the two statutes to be distinguishable in the *Bekins* case.**

The only part of the Court's opinion in the *Bekins* case which might be taken to distinguish the first statute from the second, is now set out. After quoting from a committee report on the second statute, the Court said:

"We are of the opinion that the Committee's points are well taken and that Chapter X is a valid enactment. The statute is carefully drawn so as not to impinge upon the sovereignty of the State. The State retains control of its fiscal affairs. The bankruptcy power is exercised in relation to a matter normally within its province and only in a case where the action of the taxing agency in carrying out a plan of composition approved by the bankruptcy court is authorized by state law."

This language might be taken to suggest three distinctions between the two statutes:

(1) It may imply that whereas the second statute does not impinge upon the sovereignty of the states, the first statute did. The fact is, however, that the second statute expresses no more solicitude for the sovereignty of the states than did the first. The first statute (Sec. 80(k)) provides as follows:

“Nothing contained in this chapter shall be construed to limit or impair the power of any State to control, by legislation or otherwise, any political subdivision thereof in the exercise of its political or governmental powers, including expenditures therefor, and including the power to require the approval by any governmental agency of the State of the filing of any petition hereunder and of any plan of readjustment, and whenever there shall exist or shall hereafter be created under the law of any State any agency of such State authorized to exercise supervision or control over the fiscal affairs of all or any political subdivisions thereof, and whenever such agency has assumed such supervision or control over any political subdivision, then no petition of such political subdivision may be received hereunder unless accompanied by the written approval of such agency, and no plan of readjustment shall be put into temporary effect or finally confirmed without the written approval of such agency of such plans.” (11 U. S. C., Sec. 303(k).)

In addition, Section 80(c) reads in part:

“[the court] shall not, by any order or decree in the proceeding or otherwise, interfere with (a) any of the political or governmental powers of the taxing district.” (11 U. S. C., Sec. 303(c).)

The provision of Section 80(k), quoted above, was quoted in full in the *Ashton* case (298 U. S. 513, 526).

(2) The above quotation from the Court's opinion in the *Bekins* case might be taken to imply that the statutes are distinguishable on the ground that in the second, “the bankruptcy power is exercised in rela-

tion to a matter normally within its province"; and that this is not true of the first statute. But this could not have been the Court's meaning, for plainly, if the second statute is within the province of bankruptcy, so is the first. This indeed was in effect held to be true in the *Ashton* case, where the Court said that the first statute "is adequately related to the general 'subject of bankruptcy' " (298 U. S. 513, 527).

(3) The passage quoted from the Court's opinion in the *Bekins* case might be taken to imply that there was some distinction between the two statutes concerning the consent of the state to proceedings thereunder. The rest of the opinion in the *Bekins* case, however, makes it perfectly clear that no such distinction was intended to be drawn.

**(c) The court's failure expressly to overrule the *Ashton* case is not here significant.**

The only remaining circumstances which might suggest that in the *Bekins* case the Court meant to distinguish the later statute from the earlier, is the fact that the Court did not in so many words overrule the *Ashton* case. The inference would (we submit) be unsound, both because (in view of the above discussion) it would be unreasonable in fact to distinguish them, and for the additional reason now discussed.

The considerations which guide the Court in administering the doctrine of *stare decisis* are wholly different from, and have no bearing on, the rules

which govern application of the principle of *res judicata*. In the language of Mr. Justice Brandeis, "stare decisis is not, like the rule of *res judicata*, a universal and inexorable command" (285 U. S. 393, 405).

The Courts are, of course, free to overrule earlier decisions of which they disapprove. But the fact that an earlier decision is later departed from does not impair its effect as *res judicata* in any respect.

Frequently, when the Court has not finally determined that an earlier decision should be finally disapproved, it is thought preferable to explain or distinguish it, and to leave its final disposition as a precedent to a later time. For example, the Court often announces that an earlier decision *has been* overruled, referring to intermediate decisions which did not do so in terms, but simply distinguished or explained away the earlier decision so far as necessary. See, for example:

*Morgan v. United States*, 113 U. S. 476, 496;

*Leisy v. Hardin*, 135 U. S. 100, 118;

*Brenham v. German Amer. Bank*, 144 U. S. 173, 187;

*Terral v. Burke*, 257 U. S. 529, 533;

*Lee v. Chesapeake & O. Ry.*, 260 U. S. 653, 659.

Decisions by a divided Court are considered to be of only limited authority, so far as concerns the rule of *stare decisis* (*Legal Tender Cases*, 12 Wall. 457, 553-554), although the fact that the Court was divided would not, of course, affect the force of the earlier decision as *res judicata*, in any manner or degree.

There is a considerable body of opinion that in the field of constitutional law, the doctrine of *stare decisis* is of much less force than it is in general. See the statement by Mr. Chief Justice Taney in *The Passenger Cases*, 7 How. 283, 470; and also the discussion and authorities in the dissenting opinions of Mr. Justice Brandeis in

*State v. Dawson*, 264 U. S. 219, 238;

*Burnet v. Coronado Oil & Gas Co.*, 285 U. S. 393, 405, et seq.

See, also,

*Erie R. Co. v. Tompkins*, 304 U. S. 64, 77;

Warren, *Supreme Court in the U. S. History* (ed. 1928) II, 748-749;

Goodhart, "Case Law in England and America", 15 Corn. L. Q., 173, 179-180;

1 Willoughby, *Constitutional Law* (2 ed.) Sec. 44.

The rule of *res judicata*, on the other hand, is a very different matter. It has nothing to do with the policy of judicial administration embodied in the doctrine of *stare decisis*. It is a plain and unqualified rule of law. In the language of this Court,

"It is a fundamental principle of jurisprudence, arising from the very nature of courts of justice and the objects for which they are established, that a question of fact or of law distinctly put in issue and directly determined by a court of competent jurisdiction cannot afterwards be disputed between the same parties. *Southern Pacific Railroad v. United States*, 168 U. S. 1, 48." (Frank v. Mangum, 237 U. S. 309, 333.)

The considerations which lead courts to follow, or overrule, or distinguish, or ignore, or brush aside a precedent, simply have no relevancy when a prior decision is invoked as *res judicata* between the parties.

The question, therefore, whether the prior decree between these parties is *res judicata*, is in no way affected by the answer to the question whether or not the *Ashton* case is still a living precedent.

- (d) The substantive rights described in the second statute already existed under the first, and were adjudicated upon in the first action between these parties.**

When this Court declares that a statute is invalid, its judgment does not destroy the statute, does not undo the enactment by the Congress and its approval by the Executive; the Court simply decides the controversy before it according to applicable rules of law, and applies the paramount law governing the case, namely, the Constitution.

*Marbury v. Madison*, 1 Cranch, 137, 176.

If, therefore, the Court later alters its opinion of the matter, it follows that the statute is thenceforth known to have been valid from the beginning. See authorities collected in

“Status of District of Columbia Minimum Wage Laws”, 39 Ops. Atty. Gen. 4.

It follows that if the views announced in *United States v. Bekins*, 304 U. S. 27, call for the conclusion that the first municipal bankruptcy enactment is not



inconsistent with the Constitution, then that statute was a valid enactment from the beginning, and still is a part of the law unless it has been repealed by the Congress.

The first statute certainly was not repealed by the second, for the latter declares in terms that it

“shall not be construed as to modify or repeal any prior, existing statute relating to the refinancing or readjustment of indebtedness of municipalities, political subdivisions or districts.” (Sec. 83(h), 11 USC, Sec. 403(h).)

Even if the first statute had been repealed by the second, it is plain that the second would be taken simply to continue the substantive rights created by the first: The same section just quoted makes this clear, by providing (what would otherwise be unnecessary), that the initiation of proceedings under the former statute “shall not constitute a bar to the same taxing agency or instrumentality initiating a new proceeding”, under the new statute. We submit that the provision just quoted omits, *ex industria*, to say that *final judgment* under the first statute shall not bar proceedings under the second.

The only other act of Congress which might be taken to repeal the first statute is the act of June 22, 1938 (52 Stat. 840, 939-40), wherein Congress either deprives the first act of its chapter number in the bankruptcy act (by numbering the new statute as Chapter IX), or adds the new provisions to the chapter containing the old.

Assuming this to intimate that Congress believed the decision of this Court in the *Ashton* case had de-

stroyed the first statute, that intimation, if erroneous, does not operate as an enactment of Congress' opinion.

*Endlich, Interpretation of Statutes*, Sec. 372;

*United States v. Claflin*, 97 U. S. 546, 548;

*District of Columbia v. Hutton*, 143 U. S. 18, 27.

We submit, therefore, that the statute which is the basis of this proceeding did not create new substantive rights; that the substantive rights which the District here asserts were created by the first statute, and were the subject-matter of the adjudication in the former action between these parties, which rights are therefore *res judicata*.

**(e) Even though the new statute re-created the rights created by the first, the matter is *res judicata*.**

It is apparent from the foregoing that if the first statute was valid from the beginning, then even though the second statute is said to have re-created the substantive rights created by the first, even so, the adjudication concerning the nature and scope of those rights in the prior proceeding between these parties is *res judicata* in the present proceeding.

A common application of principles applicable here is contained in decisions concerning the validity or scope of tax statutes. The levy of taxes is, of course, a purely legislative act.

*Cooley on Taxation*, Secs. 1012-1013;

*Heine v. Board*, 19 Wall. 655;

*Merriweather v. Garrett*, 102 U. S. 472;

*Taylor v. Secor*, 92 U. S. 575.

Obviously, a levy of taxes for one year is a distinct legislative act from levies concerning later years; and the liability for taxes under one levy is a different cause of action from the liability for taxes for other years. It is nevertheless settled that an adjudication of the existence or scope of the taxing power (as to a particular litigant) is *res judicata* of taxes for later years, under later tax levies and later tax statutes.

*Tait v. Western Md. Ry. Co.*, 289 U. S. 620.

As was said in *New Orleans v. Citizens Bank*, 167 U. S. 371, 400:

“It is undoubtedly true that the taxes of each year ordinarily constitute separate and distinct rights or causes of action. But where an action is brought to recover taxes paid in one year, and an action is afterwards brought to recover for the taxes paid in a subsequent year, and the adjudication in the first is pleaded as a bar to the recovery in the second action, the question whether the estoppel is effectual will depend upon the issues in the two actions.

“If the right to recover and the defense thereto are based upon precisely the same ground, why litigate again the question that has been determined? In such case the very right of the matter has been determined by a court of competent jurisdiction. It is not essential that the causes of action should be the same, but it is essential the right or title should be; that is, the issues in both actions and the matter on which the estoppel depends must be the same, or substantially so.”

- (f) Even though the second statute be taken to create new and different rights, the previous judgment is *res judicata*, because it determines the nature of the obligation of these bonds under the Constitution.

There is, we submit, no room for doubt concerning the scope of this Court's decision in the *Ashton* case. As shown above, the previous decision between these parties rested solely upon the authority of the *Ashton* case. This Court's decision in that case was not rested upon any particular provision of the first Municipal Bankruptcy Statute, but directly upon the Constitution. The Court announced the simple proposition that bonds like those here involved are immune under the Constitution from being scaled down by a federal Court in bankruptcy. The Court said in part:

"We need not consider this Act in detail or undertake definitely to classify it. The evident intent was to authorize a federal court to require objecting creditors to accept an offer by a public corporation to compromise, scale down, or repudiate its indebtedness without the surrender of any property whatsoever. \* \* \*

"Our special concern is with the existence of the power claimed—not merely the immediate outcome of what has already been attempted. \* \* \*

"The especial purpose of all bankruptcy legislation is to interfere with the relations between the parties concerned—to change, modify or impair the obligation of their contracts. The statute before us expresses this design in plain terms. It

undertakes to extend the supposed power of the Federal Government incident to bankruptcy over any embarrassed district which may apply to the court. \* \* \*

“Neither consent nor submission by the States can enlarge the powers of Congress; none can exist except those which are granted. *United States v. Butler*, decided January 6, 1936, 297 U. S. 1. The sovereignty of the State essential to its proper functioning under the Federal Constitution cannot be surrendered; it cannot be taken away by any form of legislation. See *United States v. Constantine*, 296 U. S. 287. \* \* \*

“\* \* \* for a very long time this court has steadfastly adhered to the doctrine that the taxing power of Congress does not extend to the States or their political subdivisions. The same basic reasoning which leads to that conclusion, we think, requires like limitation upon the power which springs from the bankruptcy clause. *United States v. Butler, supra.*”

We respectfully submit that until it is announced that decisions of this Court, wherein it changes its views on constitutional questions, amount to amendments of that document, it will not be proper to hold that litigants must re-litigate rights determined on constitutional grounds later abandoned by the Court.

**VII. RECONSTRUCTION FINANCE CORPORATION'S CONSENT TO THE PLAN SHOULD NOT BE COUNTED AGAINST THESE PETITIONERS, BECAUSE IT IS IN A DIFFERENT CLASS OF CREDITORS.**

It is perfectly apparent that the R. F. C.'s interest in the District is both different from and adverse to the interests of these petitioners. Moreover, under the plain language of the statute (we submit), the R. F. C. is in a different class of creditors from the objecting bondholders.

**(a) The R. F. C. is a secured creditor.**

The Bankruptcy Act, Section 83(b), provides:

“The holders of claims for the payment of which specific property or revenues are pledged, or which are otherwise given preference as provided by law, shall accordingly constitute a separate class or classes of creditors.”

The R. F. C. contract provides that the R. F. C. shall not be obligated to make the loan

“unless the Borrower shall provide for the allocation of funds and income derived from the sale of electrical power by the Borrower to the payment of the loan authorized by this Resolution in an amount and manner satisfactory to the Division Chief and Counsel.” (Ex. OO, pp. 177-8.)

And the final refunding bond purchase contract (Ex. OO, p. 202) provides for the allocation of power revenue to the maintenance of a reserve fund, and to the ultimate payment of the refunding bonds (Ex. OO, pp. 208-210).

This reserve fund was created, and now contains over \$1,000,000 (R. 669). Indeed, it was adjudicated in a proceeding brought to validate the proposed re-funding bonds to be issued to the R. F. C. (an *in rem* proceeding, R. 597-611),

“that said district has duly and regularly created said Reserve Fund and duly and regularly allocated certain of said power revenues, as hereinbefore set forth, and is and has been duly authorized to create said Reserve Fund and to make said power revenue allocation, and that the same, and each of them, are valid and binding obligations of said district.” (R. 597, 611.)

No amount of refined logic can obscure the fact that the debt owing to the R. F. C., whatever its amount and however it be evidenced, is secured by a very large amount, and has been so secured ever since it became a creditor in any imaginable sense. And under the inescapably plain language of the statute, such a creditor (even assuming it is otherwise in the same class with us), must be classified in a different class from creditors who, like the objecting bondholders, are not similarly secured.

In short the R. F. C. has (in this particular case), voluntarily contracted itself into a different class of creditors from the objecting bondholders.

- (b) **The R. F. C.'s interest in the District is both different from and adverse to the interests of these petitioners.**

This statute, like the other similar acts, requires that the judge "shall classify the creditors according to the nature of their respective claims and interests" (Sec. 83(b)).

It plainly appears from what has been said above that the R. F. C.'s interest in the District is both different from and adverse to the interests of the objecting bondholders:

(1) As shown above, the plan gives the R. F. C. all that it is entitled to in any event, the plan being indeed based directly on, and in effect incorporating, the R. F. C.'s contract with the District (R. 28).

(2) This being true, it would injure the interests of the R. F. C. if the objecting bondholders received more than the amount offered by the plan, since the District's ability to pay the R. F. C. would, to that extent, be impaired.

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**VIII. THE BONDS HELD BY R. F. C. ARE OBLIGATIONS OF THE DISTRICT ONLY AS SECURITY FOR THE R. F. C. LOAN.**

**THE DISTRICT'S DEBT IS THEREFORE ONLY HALF WHAT IT CONTENTS.**

Years before the passage of the statute upon which this proceeding rests, some 90 per cent of the District's old bondholders effected an accord and satis-



faction with the District, and a relation was established between R. F. C. and the District at that time whereby (we say) the District owes the R. F. C. only the amount advanced by that corporation, holding the surrendered old bonds in pledge as security. The District's whole case rests on its contention that the R. F. C. is a creditor to the full amount of the bonds held by it, either by the terms of its contract with the R. F. C. or by the terms of the statute, or both.

We submit that such a construction of either would be unfair and unreasonable. Even if the contract so provided, it was not then lawful (in 1934) for a debtor and creditor to contract that as against other creditors, a debt should be doubled; and even if the statute (passed years later) enacted that proposition, it does not purport to be retrospective.

**(a) As between R. F. C. and the District, the amount owing R. F. C. is only the amount loaned.**

We now consider the contract as a contract, i. e., apart from any peculiar effect it may have in a bankruptcy proceeding like this.

The R. F. C. now holds \$14,686,000, principal amount, of the District's bonds (R. 32). The total amount advanced by the R. F. C. under its contract with the District is \$7,570,871.60 (R. 88).

The negotiations between the District and R. F. C. resulted in the execution of eight documents:

1. The original R. F. C. resolution (Nov. 14, 1934) (Ex. OO, pp. 155-79);

2. Acceptance thereof by petitioner (Dec. 11, 1934) (Ex. OO, pp. 180-2);
3. An amendment of the R. F. C. resolution (July 6, 1935) (Ex. OO, pp. 192-3);
4. Acceptance thereof by petitioner (July 23, 1935) (Ex. OO, pp. 194-7);
5. An "Agreement" between R. F. C. and the petitioner (Aug. 14, 1935) (Ex. OO, pp. 217-21);
6. The "Bond Purchase Contract" (Sep. 16, 1935) (Ex. OO, pp. 202-17);
7. A second amendment to the original R. F. C. resolution (about Sept. 17, 1935) (Ex. OO, pp. 193-4);
8. Acceptance thereof by petitioner (Sept. 18, 1935) (Ex. OO, pp. 198-201).

Final completion of the contract eliminated one of these documents, namely that numbered 5 above: The "Bond Purchase Contract", which provides for the purchase of refunding bonds, incorporates, by reference, the R. F. C. resolution (No. 1, above) and the District's acceptance thereof (No. 2, above); and provides:

"This contract, together with the Resolution of R.F.C. herein referred to, and also the resolution of the Borrower, herein referred to, contain the entire agreement between the parties \* \* \*" (Ex. OO, p. 216).

**(b) The contract is governed by California law.**

The contract between the R. F. C. and the District provides in terms that "This contract \* \* \* shall be governed by and construed in accordance with the laws of the State of California" (Ex. OO, p. 216).

**(c) The contract creates a debt equal to the amount loaned.**

In every document constituting the loan contract the transaction is spoken of as a "loan" (see, e. g., Ex. OO, pp. 155, 156, 157, 158). The original R. F. C. resolution recites that the Merced Irrigation District "(herein called the 'Borrower'), has applied to this Corporation for a loan" (Ex. OO, p. 155). The parties have repeatedly, in correspondence and otherwise, made it clear that as between the District and the corporation, the transaction is considered to be a loan, by virtue of which the District owes the R. F. C. the amount loaned, and no more (see, e. g., R. 774, 778, 792, 796, 759, 762, 799, 818, 821). The list of such references could be multiplied almost indefinitely.

The contract provides in part (Ex. OO, p. 165):

"if the Borrower shall, before any New Bonds are delivered to this Corporation, pay or cause to be paid to this Corporation an amount equal to the disbursements it has made to or for the benefit of the borrower with 4% interest thereon until paid, this Corporation will thereupon surrender or cause to be surrendered the Old Securities then held by it or on its behalf to the Borrower."

The R. F. C. has no authority to purchase bonds, but only to make loans. The only authority of R. F. C. to participate in such transactions is Section 36 of the Emergency Farm Mortgage Act (43 U. S. C., Sec. 403); the statute simply authorizes loans, which must be secured.

**(d) No contract provision contradicts the provisions creating a secured loan.**

The contract provides, among other things, as follows:

"All disbursements made by this Corporation for the purpose of acquiring the Deposited Securities, or rights in or to the same, shall be deemed to be and shall constitute disbursements from the loan authorized herein" (Ex. OO, p. 158).

Disbursement is to be made—

"to or for the benefit of the Borrower through the purchase of securities issued or to be issued by the Borrower or upon promissory notes collateralized by the obligations of the Borrower \* \* \*" (Ex. OO, p. 159(b)).

"All or any part of the Old Securities acquired or held \* \* \* through any disbursement \* \* \* as well as all rights in or to such Old Securities may be kept alive for a greater or lesser time and for any purpose the Division Chief and Counsel may deem necessary" (Ex. OO, p. 164(c)).

"\* \* \* Until such Old Securities have been exchanged for New Bonds, all such securities as well as all rights in or to the same shall continue to be and constitute obligations of the Borrower

for the full amount thereof and nothing in this resolution shall be deemed to limit the right of this Corporation to enforce or cause to be enforced full payment of principal and interest of such Old Securities as and when the Division Chief and Counsel shall deem it advisable to do so \* \* \* (Ex. OO, pp. 164-165).

The District contends that these provisions actually make the R. F. C. a creditor of the District to the full amount of the bonds including unpaid interest. This argument necessarily says in effect that the contract meant one of two things (although it does not say which):

1. "In consideration of the loan of so much, the borrower agrees to pay either the amount borrowed or approximately twice that amount, as the lender may elect", or

2. "As between ourselves, the RFC must accept refunding bonds in the amount loaned; but as against any holder of old bonds who refuses to surrender them, the parties hereto may assert that the full amount of the old bonds surrendered are an actual debt of the borrower to the RFC."

Neither of these constructions is tenable, for a number of reasons:

- (a) Both would be illegal, and void for the excess over the actual debt, under the California law, which governs by express provision (Ex. OO, p. 216).

- (b) Both would be grossly usurious, and void for the excess as a penalty (*Cal. Const.*, Art XX, Sec. 22;

3 *Williston on Contracts* (2d Ed.), Sec. 781; 5 *id.*, Sec. 1407).

(c) The second construction would be contrary to the plain language of the contract. This, because there is not even a suggestion that the R. F. C.'s alleged option to demand double payment shall cease if all of the old bonds are brought in. On the contrary, the R. F. C.'s apparent discretion is absolute. Indeed, the clause says so; it says that if in any way the R. F. C. should "acquire legal title to all, or any part" of the old bonds, then "in its discretion" the R. F. C. may keep the old bonds alive "for any purpose" (Exhibit OO, p. 203).

In other words, if the provision in question is taken to give the R. F. C. the right, at its election, to demand full payment of the old bonds, then inescapably the R. F. C. has that power in any event, i. e., whether all of the old bonds are surrendered or not. It follows that the second of the two possible constructions for which appellee contends is contradicted by the contract itself.

(d) But the first possible construction (set out above) is, in addition to being illegal under California law, simply fantastic, and contrary to common sense.

It is significant, therefore, that an alternate and entirely reasonable interpretation of the provision is possible, namely, this:

The parties intended, we submit, to provide by this provision that the R. F. C.'s **security rights** in the old

bonds shall include the full rights of an owner, up to, and as security for, the amount owing. Although the R. F. C. would probably have those rights as pledgee without express provision, an express provision is nevertheless both natural and desirable, as is shown by the large amount of litigation that arises, in cases of partial refinancing, over this precise question, namely, the question whether one who has made a loan to a debtor on the security of part of an old bond issue may assert, **as security for the loan** the rights of an outright owner of old bonds. See the many cases on the question discussed in 47 *Harvard Law Review*, 1093-1126, and 81 A. L. R. 139-146.

- (e) **No provision in the statute (we submit) permits debts extinguished before its enactment to be revived for the purposes of this proceeding.**

Section 82 of the Bankruptcy Act (11 U. S. C., 402) provides in part:

“Any agency of the United States holding securities acquired pursuant to contract with any petitioner under this chapter shall be deemed a creditor in the amount of the full face value thereof.”

The earlier Act contained no such provision. And Section 83(j) of the Act reads as follows:

“The partial completion or execution of any plan of composition as outlined in any petition

filed under the terms of this Act by the exchange of new evidences of indebtedness under the plan for evidences of indebtedness covered by the plan, whether such partial completion or execution of such plan of composition occurred before or after the filing of said petition, shall not be construed as limiting or prohibiting the effect of this Act, and the written consent of the holders of any securities outstanding as the result of any such partial completion on execution of any plan of composition shall be included as consenting creditors to such plan of composition in determining the percentage of securities affected by such plan of composition."

Section 83(j), just quoted, was added to the statute by an amendment of June 22, 1938, and went into effect three months later, i. e., on September 22, 1938 (52 Stat. 840, 940).

The R. F. C.'s consent to the plan here proposed was executed June 8, 1938 (R. 6, 32). This action was commenced June 17, 1938 (R. 8, 36). We submit that this statutory provision, enacted after the action was commenced, cannot add to or change the effect of the R. F. C.'s consent to the plan.

The provision quoted above from Section 82 should not (we submit) be construed as providing that even though the District's debts have been reduced by half (through an accord and satisfaction with most of its old bondholders) followed by a pledge of the old bonds as security for a loan, all before the statute was passed, nevertheless, for purposes of bankruptcy proceedings, the District is to be treated as if it still



owed the amount which it owed, in fact, some years before the proceeding was commenced.

As we presently show, the R. F. C. has ample powers to participate in refinancing transactions without the aid of a statute so construed. Moreover, an alternative, and an entirely reasonable construction, is available.

(1) The Court may doubtless take judicial cognizance of the fact that R. F. C. does advance money in aid of refinancing schemes without reducing the obligations of the debtor until after the scheme has been carried out. Thus, it may postpone actual disbursement; or it may make a loan to a trustee or committee for the bondholders (secured by the old bonds), waiving personal liability. This latter method was employed in at least one case, *Leuhrmann v. Drainage Dist. No. 7*, 21 Fed. Supp. 801, 802.

The R. F. C. is, in short, in no need of so drastic a provision as this one would be if construed as the District contends it should be.

(2) Another and entirely reasonable construction is available: The statute (Section 82) defines the term "creditor" as a "holder" of securities.

Now a pledgee is, of course, a "holder" of the securities held in pledge. But the pledgee's status as a holder does not increase the debts of the pledgor, even though the securities held in pledge are the pledgor's own obligations.

The law on this question appears to be fairly clear. Although the transaction is anomalous, it appears to

be settled that a debtor may pledge its own bonds: As security for his promise to pay \$1000, a debtor may pledge an instrument which is simply another promise by him, to pay another \$1000. When it does so, the pledgee may realize on (i. e., obtain a judgment upon) the pledged promise, in addition to obtaining a judgment on the main promise, as security for which the instrument was pledged. But the pledgee may, of course, obtain only one satisfaction, that is to say, may actually collect only the amount actually owing.

*Anglo-California Trust Co. v. Oakland Railways*, 193 Cal. 451;

*Murphy v. Murphy*, 74 Conn. 198.

In the event of bankruptcy proceedings, moreover, the only amount which the pledgee may prove is the amount owing on the actual debt.

*Sauve v. Fleschutz*, 219 Fed. 542;

*Butterfield v. Woodman*, 223 Fed. 956;

*In re Sullivan Condensed Milk Co.*, 291 Fed. 66.

Taking account of this rule, we submit that the provision of the Municipal Bankruptcy Act under inquiry (providing that a public agency holding securities pursuant to contract with the petitioner shall be deemed a "creditor", i. e., a holder, in the amount of "the full face value thereof"), should be taken simply to codify the rule just discussed.

In other words, the provisions should be taken to mean that a public agency which makes a loan in aid of a refinancing scheme, taking the old bonds sur-

rendered as security for its loan, shall have the remedies of any holder of bonds for the purpose of insuring repayment of its loan.

(3) The statute might also be reasonably construed as settling the much vexed question of the rights of a pledgee of a corporation's own bonds as against outright owners of similar bonds. It is obviously possible to hold either (a) that such a pledgee can claim a proportion of assets measured by the amount of his actual debt, or (b) that as against other creditors he is entitled to a proportion of assets equal to the proportion which the securities held by him in pledge bear to all similar securities. See the many cases on this question discussed in 47 *Harvard Law Review*, 1122; 81 A. L. R. 146.

This statute settles the choice between these alternatives.

**(f) The bondholders who surrendered their bonds did so irrevocably.**

There is no doubt of the proposition stated in the heading. The District has never argued, and we assume will not now argue, that the old bondholders can ever again assert any interest in the bonds surrendered by them (in 1935, for the most part). They were each required to execute "A Memorandum of Sale and Receipt" upon being paid 51.501¢ on the dollar of principal, wherein they unconditionally sold the old bonds and accepted the amount paid "in full payment therefor" (R. 571, 572).

**IX. IF THE PLAN IS CONFIRMED, IT SHOULD IN ANY EVENT BE ON CONDITION OF PAYMENT TO OBJECTING BONDHOLDERS OF FOUR PER CENT INTEREST.**

This plan tells the bondholder that he must accept the amount offered in full satisfaction of an undisputed debt, or else forego the enjoyment thereof for such number of years as it will take to litigate it, receiving no interest in the meantime. Such a plan is contrary, we submit, to the purposes of the statute, which certainly was not intended to permit petitioning districts thus to subject their bondholders to substantial coercion in order to induce acceptance of plans believed by the bondholders to be unfair. See:

*Manning v. Brandon Corporation*, 163 So. Car. 178.

The money necessary to carry out the plan first became available for tender to the bondholders on October 4, 1935 (R. 344), and the major portion of the bondholders then surrendered their bonds and received the cash (R. 344). Since then the District has paid the R. F. C. 4% interest on the amount advanced.

The plan (R. 28) does not contemplate payment of any interest to objecting bondholders. If it is confirmed, and confirmed unconditionally, they will receive only the amount of the cash offer, without interest.

We submit that denial of any interest to objecting bondholders makes the plan unfair; and if confirmation of the plan is to stand, the decree should make the confirmation conditional upon payment to objecting bondholders of 4% interest from the time of the first

disbursement to consenting bondholders. This for the following reasons:

(1) In the first place, there is no question but what a bankruptcy court, as a court of equity, has power to impose conditions, on equitable principles, so long as those principles are not inconsistent with the Bankruptcy Act.

*Securities & Exchange Commission v. U. S. Realty & Improvement Company*, ..... U. S. ...., 60 S. Ct. Rep. 1044, 1053-4.

The principle that an equitable decree must not be unfair is not only a fundamental principle of equity but an express command of this statute. This being true, this Court's power to grant the relief on conditions which will make its operation fair and equitable is not only within its power but a part of its duty.

(2) Secondly, and apart from the foregoing, we submit that the Act should not be construed as authorizing a plan (as here) whereby the bondholders' unquestioned right to object to the plan, and to ask for judicial examination of its fairness, is seriously handicapped and penalized by the plan itself.

(3) It is important to observe that payment of interest to the objecting bondholders will not require the District to make any payment whatever beyond what the plan itself contemplated. The central theory of the plan is that the District proposes to borrow money at 4% wherewith to discharge its bonds at 51.501¢ on the dollar. The actual operation of the plan under the decree is that the District saves 4% for five years on the entire amount admittedly owing to the

objecting bondholders (by the very terms of the plan) from the beginning; and they in turn are penalized in an equal amount by being deprived of both the use of their money and interest thereon during the entire period of litigation.

Surely the District should not thus profit, nor should the objecting bondholders thus suffer (as compared with consenting bondholders), solely because they objected to the plan on the ground that they believed it to be unfair.

(4) The most obvious analogy to the present situation in private law is the effect of a tender as stopping interest. It is settled that a conditional tender does not stop the running of interest.

6 *Williston on Contracts* (Rev. Ed.) 5144.

More particularly, a tender on condition that the creditor surrender a right then in litigation between the parties is no tender at all, and is ineffective, therefore, to stop the running of interest.

*Cameron County Improvement Dist. No. 8 v.*

*De la Vergne*, 100 F. (2d) 523.

So here, the plan was in substance a tender to the bondholders of much less than half the amount owing to them (taking account of unpaid interest), made on condition that the amount tendered be accepted in full satisfaction of the debt. Whether or not the bondholders were bound to accept the amount tendered as full satisfaction (i. e., whether or not the plan was "fair") was, as a matter of law, a question which the bondholders could with entire justice and propriety dispute.

For the foregoing reasons, we submit, to say that the offer of the plan stopped the running of the interest on the amount ultimately found owing is contrary to the reasonable construction of the statute, is eminently unfair and inequitable, and is contrary to analogous rules of law.

We earnestly submit, therefore, that if the plan is to be confirmed, this Court should impose, as a condition to affirmance, that the objecting bondholders be paid interest at 4% from the date of the original disbursement by the R. F. C. (October 4, 1935, R. 344) to the date of actual payment.

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**X. THE STATE PROCEEDING UNDER A STATE INSOLVENCY LAW, STILL PENDING BETWEEN THESE PARTIES, MAY BAR THIS PROCEEDING.**

On May 25, 1936, this Court held that the first Municipal Bankruptcy Act was void, in the *Ashton* case (298 U. S. 513). On March 30, 1937, a California statute was approved, effective immediately, entitled "Irrigation District Refinancing Act" (Cal. Stats. 1937, pp. 92-101). It provides for submission to the state courts by irrigation districts of refinancing plans. If the plan is found to be fair, an interlocutory judgment is entered. This judgment purports to establish the public necessity for condemnation of non-consenting bonds, and the case then proceeds as an ordinary condemnation proceeding, at which the value of the bonds is determined, but must not be found to exceed the amount offered by the plan. Upon pay-

ment of the value so fixed, the bonds are taken for public use.

Thereafter, on August 16, 1937, Congress enacted the present Municipal Bankruptcy provisions (50 Stat. 654), which were held to be valid by this Court in *United States v. Bekins*, 304 U. S. 27, on April 25, 1938. On June 17, 1938, the present proceeding was commenced (R. 8, 36).

Notwithstanding the pendency of the present proceeding, the District, on March 10, 1938, commenced a proceeding under the state statute described above, presenting to the Court the identical plan here involved (R. 381-3). After this Court sustained the second municipal bankruptcy statute, the District suspended action in the state proceeding, which is still pending. In the present proceeding, we pleaded the pendency of this state court proceeding (R. 48, 66, 67, 69, 70, 123).

We submit that the California statute in question is void under the rule laid down in *Sturges v. Crowninshield*, 4 Wheat. 122.

If it is valid, however, the question is presented whether the plea of another action pending was good. There is not, so far as we know, any controlling authority on the question whether or not, in such a situation, a state proceeding under a valid state insolvency law, pending at the time the Congress occupies the field under its bankruptcy power by enactment of or amendment to a bankruptcy law, is superseded by the federal statute.



If we are right in our contention (point VI, *supra*) that the first Municipal Bankruptcy Act, passed prior to the enactment of the state statute, is now known to have been valid from the beginning, then we submit that the state statute is void, not only as an impairment of the obligation of contract, but also because the field which it endeavors to invade was already occupied by the federal statute.

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**XI. IT IS NOW SETTLED BY LOCAL LAW THAT THE FUNCTIONS OF CALIFORNIA IRRIGATION DISTRICTS ARE STRICTLY GOVERNMENTAL.**

Since the decision of this Court in *United States v. Bekins*, 304 U. S. 27, the Supreme Court of California has said of irrigation districts that their "functions are considered exclusively governmental; their property is state owned, held only for governmental purposes \* \* \*" (*El Camino Irrigation District v. El Camino Land Corp.*, 12 Cal. (2d) 378, 383). See also:

*Moody v. Provident Irrigation District*, 12 Cal. (2d) 389, 395;

*Anderson-Cottonwood Irrigation District v. Klukkert*, 13 Cal. (2d) 191, 197.

It is also true that in *Peoples State Bank v. Imperial Irrigation District*, ..... Cal. (2d) ....., 99 Cal. Dec. 317, the State Supreme Court upheld the California statute consenting to proceedings like this one.

That decision, however, rests on the proposition (mistakenly, we submit) that this Court's decision in

the *Bekins* case settled the validity, under both state and federal Constitutions, of such state statutes.

We submit that all these cases taken together raise the question whether or not it can now be said that the Municipal Bankruptcy Act confers jurisdiction of proceedings like this one, affecting California irrigation districts: This in view of the provisions of the federal statute (Sec. 83(i)), that

“Nothing contained in this chapter shall be construed to limit or impair the power of any State to control, by legislation or otherwise, any municipality or any political subdivision of or in such State in the exercise of its political or governmental powers, including expenditures therefor.”;

and the provision of Section 83(c) that the judge

“shall not, by any order or decree, in the proceeding or otherwise, interfere with (a) any of the political or governmental powers of the petitioner; or (b) any of the property or revenues of the petitioner necessary for essential governmental purposes; or (c) any income-producing property, unless the plan of composition so provides.”;

and in view of the proposition that the Congress has no authority to alter the division of powers between State and Nation, even though a particular state (or all the states) consent.

**CONCLUSION.**

It is submitted that the writ of certiorari should be granted, the decree of the Court below reversed, and the proceeding directed to be dismissed.

Dated, San Francisco, California,  
November 18, 1940.

Respectfully submitted,

HERMAN PHLEGER,

PETER TUM SUDEN,

W. COBURN COOK,

*Counsel for Petitioners.*

HUGH K. McKEVITT,

NEWELL J. HOOEY,

CLARK, NICHOLS & ELTSE,

GEORGE CLARK,

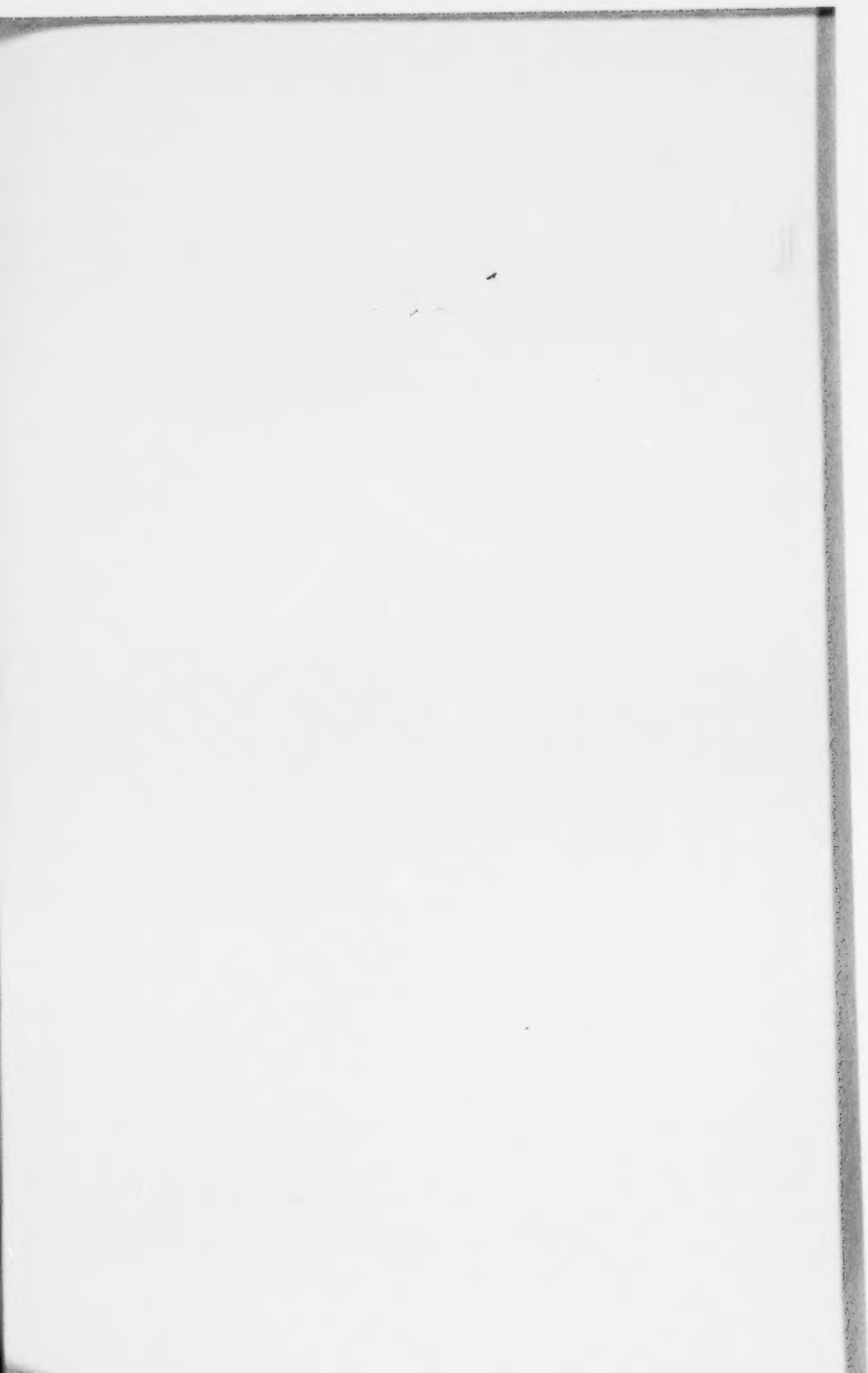
CHASE, BARNES & CHASE,

LUCIUS F. CHASE,

DAVID FREIDENRICH,

BROBECK, PHLEGER & HARRISON,

*Of Counsel.*



*Due service and receipt of a copy of the within is hereby admitted*

*this.....day of November, 1940.*

.....

.....

.....

.....

*Counsel for Respondent.*

*End*





# In the Supreme Court

OF THE  
**United States**

OCTOBER TERM, 1940

No. 591

- Supreme Court, U. S.

FILED

DEC 16 1940

CHARLES ELMORE CROPLEY  
CLERK

PACIFIC NATIONAL BANK OF SAN FRANCISCO,  
a national banking association, et al.,

*Petitioners,*

vs.

MERCED IRRIGATION DISTRICT,

*Respondent.*

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## PETITIONERS' REPLY BRIEF

in Support of Petition for Writ of Certiorari to the United States  
Circuit Court of Appeals for the Ninth Circuit.

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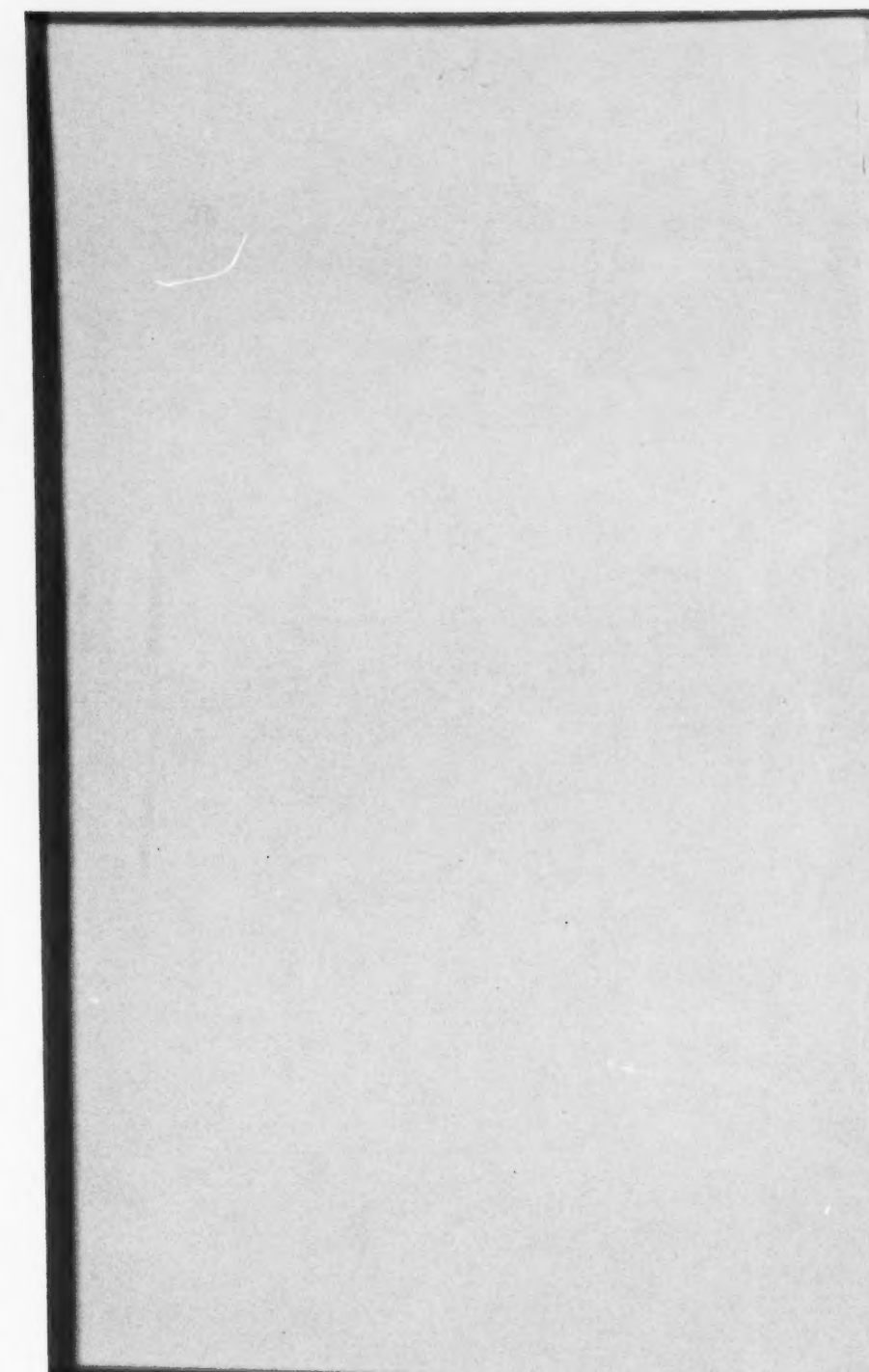
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*Of Counsel.*





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# In the Supreme Court

OF THE  
**United States**

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OCTOBER TERM, 1940

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No. 591

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PACIFIC NATIONAL BANK OF SAN FRANCISCO,  
a national banking association, et al.,  
*Petitioners,*

VS.

MERCED IRRIGATION DISTRICT,  
*Respondent.*

## PETITIONERS' REPLY BRIEF

in Support of Petition for Writ of Certiorari to the United States  
Circuit Court of Appeals for the Ninth Circuit.

---

The brief of respondent in opposition to our petition for writ of certiorari discusses two matters in a manner which we believe requires brief comment.

## I.

**THE LACK OF FINDINGS OF FACT ON THE ISSUE OF FAIRNESS WAS ADEQUATELY RAISED BELOW.**

At page 6 of the Brief for Respondent it is said:

“Furthermore, it does not appear in the petition that petitioners seasonably raised the point which they now urge with greatest emphasis, i. e., that the finding that the plan was ‘fair, equitable and for the best interest of its creditors’ was not a finding of fact.

In the opinion of the Circuit Court there is no such indication. In the District Court in the formal objections made by petitioners to the signing of the findings of fact the proposed finding of fairness is objected to (R. 196) and the claim is made that the evidence fails to sustain it (R. 198), but it is not objected that it is not a finding of fact.”

The answer is plain. In the first place,

“Requests for findings are not necessary for purposes of review.” (*Federal Rules of Civil Procedure*, Rule 52(a), in part.)

It is true, as stated by respondent, that “in the opinion of the Circuit Court there is no such indication” (that we raised the objection below that the finding concerning fairness was inadequate). The fact is, however, that the question, whether the general finding of fairness is sufficient, was dealt with at length, (a) in our briefs in the Circuit Court of Appeals, (b) in the oral argument before that Court, and (c)

in a supplementary memorandum filed by us after the oral argument (at the request of the Circuit Court of Appeals), devoted solely to the question whether the general finding of fairness is sufficient.

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## II.

### **THE RULE OF AMERICAN ETC. LIFE INS. CO. v. CITY OF AVON PARK (Decided November 25, 1940) IS APPLICABLE HERE.**

Respondent's brief says at page 10:

"The record is definite that negotiations were openly, fairly and honestly conducted and the bondholders themselves (not a committee or fiscal agent) with an able, disinterested study of the State University before them, decided the issue by referendum (R. 499) in glaring contrast with the method condemned by this court in *American etc. Life Ins. Co. v. City of Avon Park* decided November 25, 1940. Here there is not a suggestion of coercion, oppression or fraud."

This statement of respondent should not obscure the following facts:

(a) The Chairman of the Bondholders' Committee, which participated in the formulation of the plan confirmed below, was a representative of the Bank of America. That corporation was not only a bondholder but also, through subsidiaries, was heavily involved in the district as a mortgagee of lands therein, and actually owned over 3000 acres of land in the district.

(b) The consent to the plan here involved consisted solely of the consent of Reconstruction Finance Corporation. The plan is based directly on, and follows the terms of, that Corporation's loan to the district. It is shown at length in our petition and supporting brief that that Corporation occupies a position far different from, and indeed hostile to, the position occupied by the objecting bondholders.

The foregoing matters are dealt with in our petition and supporting brief, at pages 15 to 16, 17 to 20, 27 to 29 and 71 to 84.

It is, we believe, apparent from what appears in our petition and supporting brief that the rule of *American United Mutual Life Insurance Company v. City of Avon Park, Florida*, decided November 25, 1940, .....U. S. ...., 9 U. S. Law Week., p. 4027, and of the decisions there cited, is directly applicable here.

## III.

## CONCLUSION.

Other matters discussed in the brief of respondent are, we believe, sufficiently dealt with in our petition and supporting brief.

Dated, San Francisco, California,  
December 14, 1940.

Respectfully submitted,

HERMAN PHLEGER,

PETER TUM SUDEN,

W. COBURN COOK,

*Counsel for Petitioners.*

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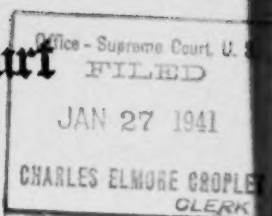


# In the Supreme Court

OF THE  
**United States**

OCTOBER TERM, 1940

**No. 591**



PACIFIC NATIONAL BANK OF SAN FRANCISCO  
(a national banking association), et al.,  
*Petitioners,*

vs.

MERCED IRRIGATION DISTRICT,  
*Respondent.*

## PETITION FOR A REHEARING.

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BROBECK, PHLEGER & HARRISON,  
*Of Counsel.*



# In the Supreme Court

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United States

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PACIFIC NATIONAL BANK OF SAN FRANCISCO  
(a national banking association), et al.,  
*Petitioners,*

vs.

MERCED IRRIGATION DISTRICT,

*Respondent.*

---

## PETITION FOR A REHEARING.

*To the Honorable Charles Evans Hughes, Chief Justice of the United States, and to the Associate Justices of the Supreme Court of the United States:*

Come now the petitioners herein, PACIFIC NATIONAL BANK OF SAN FRANCISCO, a national banking association, MARY E. MORRIS, R. D. CROWELL, BELLE CROWELL, MINNIE E. RIGBY as Executrix and RICHARD TUM SUDEN as Executor of the Last Will of William A. Lieber, Alias, Deceased, MILO W. BEKINS and REED J.

BEKINS as trustees appointed by the Will of Martin Bekins, Deceased, MILO W. BEKINS and REED J. BEKINS as trustees appointed by the Will of Katherine Bekins, deceased, REED J. BEKINS, COOLEY BUTLER, CHAS. D. BATES, LUCRETIA B. BATES, EDNA BICKNELL BAGG, JOHN D. BICKNELL BAGG, MARY B. CATES, NANCY BAGG EASTMAN, CHARLES C. BAGG, HORACE B. CATES, BARKER T. CATES, MARY EDNA CATES ROSE, MILDRED C. STEPHENS, N. O. BOWMAN, W. H. HELLER, FANNIE M. DOLE, JAMES IRVINE, J. C. TITUS, SAM J. EVA, WILLIAM F. BOOTH, JR., GEORGE N. KEYSTON, GEORGE W. PRACY, H. T. HARPER and GEORGE B. MILLER as trustees of Cogswell Polytechnical College, TULOCAY CEMETERY ASSOCIATION, a corporation, PERCY GRIFFIN, EMOGENE COWLES GRIFFIN, D. LYLE GHIRARDELLI, A. M. KIDD, GRAYSON DUTTON, STEPHEN H. CHAPMAN, EDITH O. EVANS, J. OFELTH, DANTE MUSCIO, I. M. GREEN, JULIA SUNDERLAND, LILY SUNDERLAND, FLORENCE S. RAY, JOSEPH S. RAY, AMELIA KINGSBAKER, S. LACHMAN COMPANY, a corporation, SUE LACHMAN, SOPHIA MACKENZIE, NETTIE MACKENZIE, R. J. McMULLEN, GILBERT MOODY, WILLIAM PAYNE, G. H. PEARSALL, SHERMAN STEVENS, E. G. SOULE, MARGARET B. THOMAS, ISABELLA GILLETT and EFFIE GILLETT NEWTON as executrices of the Estate of J. N. Gillett, deceased, THEO. F. THEIME, FLETCHER G. FLAHERTY, FRANCES V. WHEELER, MIRIAM H. PARKER, APPHIA VANCE MORGAN, FIRST NATIONAL BANK OF POMONA, GEORGE F. COVELL, ALMA H. WOORE, GEORGE HABENICHT, SETH R. TALCOTT, ADOLPH ASPEGREN, J. H. FINE, MRS. J. H. FINE, F. F. G. HARPER, W. S. JEWELL, FLORENCE MOORE, AMERICAN TRUST COMPANY

as trustee under a certain agreement between R. S. Moore and American Trust Company dated December 15, 1927, CROCKER FIRST NATIONAL BANK as trustee under a certain agreement between Florence Moore and Crocker First Federal Trust Company, dated December 15, 1937, and present this, their petition for a rehearing of the Petition for a Writ of Certiorari herein, and in support thereof respectfully show:

Although the debtor District has corporate assets (bought with the bondholders' money) worth more than two and one-half times the amount offered by the plan of debt readjustment, as its own records show;

Although the lands in the District, which are subject to taxation for the debt, have a market value more than four times the amount offered by the plan, as is shown by the testimony of the District's own and only witness on value produced at the trial;

Although most, if not all of these petitioners paid approximately par for their bonds, under a contract whereby the bonds are secured by the lands in the District, which lands are "impressed with a trust" to pay the bonds and "can never be permanently released from the obligation of the bonds until they are paid" (12 Cal. (2d) 365);

Although the District owns a hydro-electric plant (bought with the bondholders' money) from which it derives an assured income more than sufficient to discharge the proposed refunding bonds, without any contribution from the landowners whatsoever;

Although under express provisions of the California Statutes, the District is empowered to convey its corporate properties to its bondholders in satisfaction of the bonds, to be operated by them as a public utility bound to serve all indifferently at reasonable rates;

Although the District's average annual income from assessments during its entire life (since its creation in 1919), plus average annual power revenue, has been enough to amortize, in 35 years at 4% (the terms of the refunding bonds proposed by the plan), a debt more than twice the amount offered by the plan;

Although no evidence even suggests that the District's future income will be less than its past income, but on the contrary the evidence indicates a future income much larger than that of the past;

Although the plan approved below was carried through by a committee led by a bondholder who was also a large landowner in the District and who also held a very large amount of debts secured by mortgages on lands therein;

Although years before this proceeding was commenced, and indeed before enactment of the statute on which it rests, the District (as we submit) became the beneficial owner of all the bonds purportedly consenting to the plan herein, all of which are held in pledge by Reconstruction Finance Corporation;

Although the Court below, while classifying Reconstruction Finance Corporation as a creditor of the same class as objecting bondholders for voting purposes, nevertheless denied objecting bondholders five

years' interest at 4% paid to Reconstruction Finance Corporation, the only consenting bondholder;

Although a previous judgment in favor of these petitioners against the District denied the identical relief here sought, applying the rule then existing that these bonds are immune under the Constitution from being scaled down by a federal bankruptcy Court;

Notwithstanding all this, the Court below confirmed the plan, scaling down the District's bonded debt (its other debts are inconsiderable) to approximately 37% of the amount thereof, and in so doing contradicted this Court's views on the subject of what is a fair plan under statutes like this, the doctrine of *res judicata*, and other rules discussed in our brief herein.

Not all of the matters enumerated above appear in the opinions below. As to those which do not, we submit that the opinions constitute a variety of unfairness which this Court should not condone, but should declare to be a departure from the accepted and usual course of judicial proceedings calling for an exercise of this Court's power of supervision.

The Congress has not enacted a policy that the public welfare will be subserved by radical curtailment of debts regardless of ability to pay.

The Congress has not enacted a policy that the public welfare will be subserved by relieving debtors of their debts even though the security pledged therefor exceeds the amount thereof. On the contrary, under the principles announced by this Court in *Case v. Los Angeles Lumber Products Co.*, 308 U. S. 106,



the Congress, by requiring that the plan be "fair", enacted that no plan scaling down debts shall be approved where the available assets of the debtor exceed the amount offered by the plan. *A fortiori*, the statute says, no plan scaling down debts shall be approved where, as here, the property pledged as security for the debt exceeds the amount of the debt in question, and is several times the amount offered by the plan.

Under submission, we believe that the most elementary principles of common honesty forbid approval of the plan here involved. We submit that departure from those principles is not in the public interest.

If the picture painted in the brief for respondent herein were a fair statement of the case, it is conceivable that this Court might believe that the landowners in Merced Irrigation District could not pay the amount of the District's debts out of income from the lands in the District, that recourse to the security, i. e., to those lands, might therefore be necessary to pay the debts in question, and that this would be undesirable. The simple fact is, however, that no such situation is presented, as we show in our brief.

Moreover, the decision in this case has been awaited by both bench and bar, because it raised, and called for discussion of, substantially all of the important questions of law, policy and administration presented by the Municipal Bankruptcy Act. In our brief we attempt to show that several statements and implications in the opinion below call for correction and clarification by this Court.

For the foregoing reasons it is respectfully urged that this petition for a rehearing be granted, and that a Writ of Certiorari be issued out of and under the seal of this Honorable Court as prayed for in the petition for Writ of Certiorari herein.

Dated, January 21, 1941.

Respectfully submitted,

HERMAN PHLEGER,

PETER TUM SUDEN,

W. COBURN COOK,

*Counsel for Petitioners.*

HUGH K. McKEVITT,

NEWELL J. HOOEY,

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*Of Counsel.*

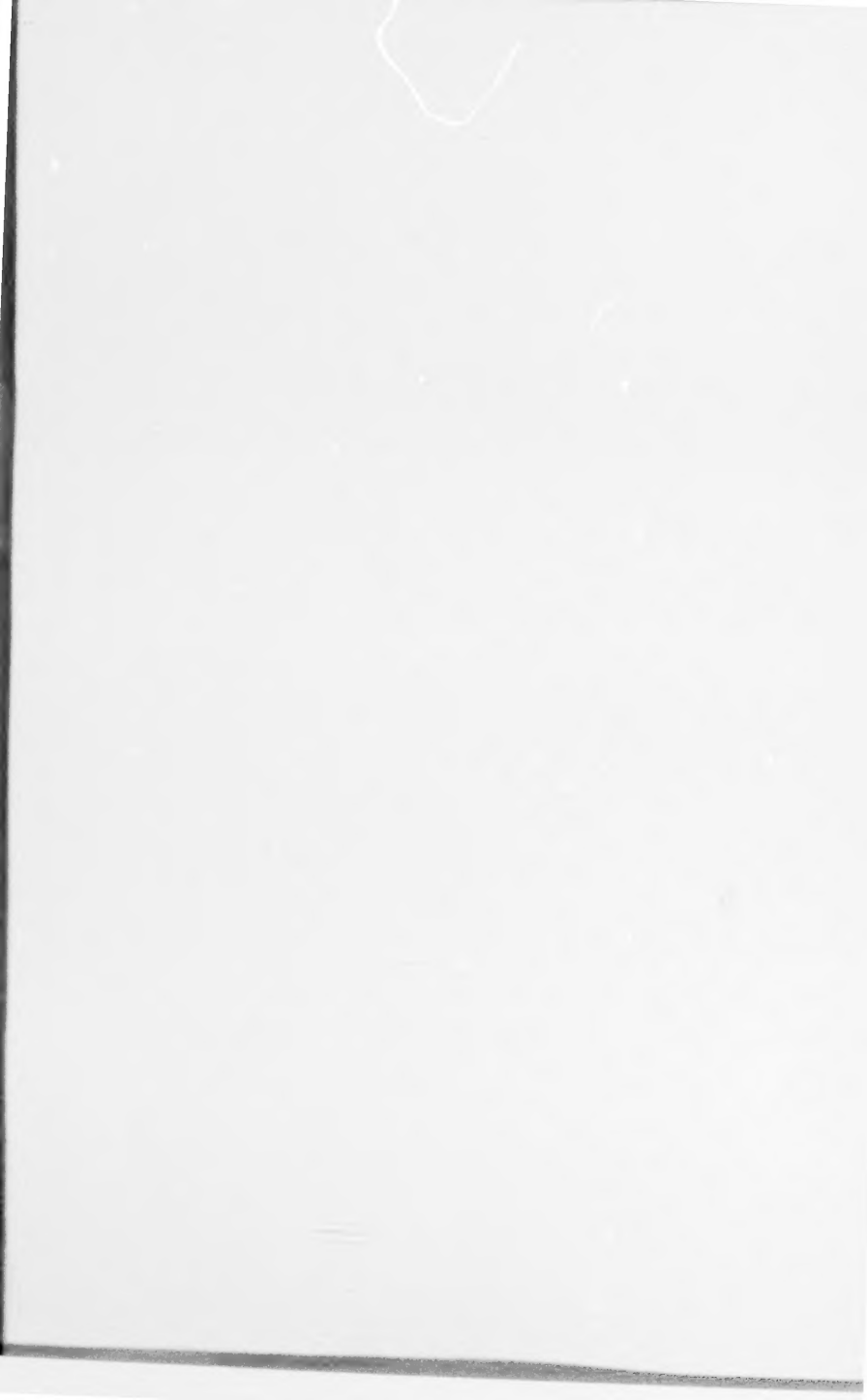
## CERTIFICATE OF COUNSEL.

We, Herman Phleger, Peter tum Suden and W. Coburn Cook, counsel for the above-named petitioners, do hereby certify that the foregoing petition for a rehearing of this cause is presented in good faith and not for delay.

Dated, January 21, 1941.

HERMAN PHLEGER,  
PETER TUM SUDEN,  
W. COBURN COOK,  
*Counsel for Petitioners.*



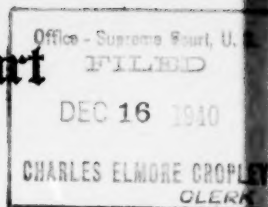


# In the Supreme Court

OF THE  
**United States**

OCTOBER TERM, 1940

**No. 591**



PACIFIC NATIONAL BANK OF SAN FRANCISCO  
(a national banking association), et al.,

*Petitioners,*

vs.

MERCED IRRIGATION DISTRICT,

*Respondent.*

**BRIEF FOR RESPONDENT, IN OPPOSITION TO  
PETITION FOR WRIT OF CERTIORARI  
to the United States Circuit Court of Appeals  
for the Ninth Circuit.**

**STEPHEN W. DOWNEY,**

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*Counsel for Respondent.*

**C. RAY ROBINSON,**

Shaffer Building, Merced, California,

**HUGH K. LANDRAM,**

Bank of America Building, Merced, California,

**DOWNEY, BRAND & SEYMOUR,**

Capital National Bank Building, Sacramento, California,

*Of Counsel.*



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# In the Supreme Court

OF THE  
United States

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OCTOBER TERM, 1940

---

No. 591

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PACIFIC NATIONAL BANK OF SAN FRANCISCO  
(a national banking association), et al.,  
*Petitioners,*

VS.

MERCED IRRIGATION DISTRICT,  
*Respondent.*

## BRIEF FOR RESPONDENT, IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI.

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### STATEMENT OF CASE.

The record is a long and often tragic story of the District's financial difficulties and its efforts to save itself and bondholders from total loss. The following will suffice to give the background and to show the inappropriateness of certiorari.

In 1932 the District went 62.80% delinquent with a tax rate of \$8.90 per \$100 assessed valuation (R. 402). For the year 1933 it faced a levy of \$15.60 (R. 506,

Ex. 37; R. 740). Obviously refinancing was necessary (R. 495). The power to tax was "useless" and the command to do so "mere futility."<sup>2</sup>

The University of California was requested jointly by the District and Bondholders (R. 433-4) to make a survey of the District's tax paying ability to the end that refinancing action might be taken fairly and intelligently. This report (R. 441, Ex. 35; R. Vol. IV) (also called the Benedict or Gianinni Foundation Report) was made after nine months of careful study (R. 435), is scientific and impartial, was thoroughly explained by its author, Dr. Benedict (R. 432-494), and was particularly relied on by the trial judge (R. 176) and the Circuit Court (R. 1060) in determining that the plan is fair. The survey disclosed that even when agricultural prices were comparatively high, assessments in considerable measure were not being yielded by the lands (R. 440-442, 456).<sup>3</sup> They came from outside sources—money borrowed, surpluses of corporations, savings accounts. When these were exhausted, collapse was inevitable. A letter signed by members of the Bondholders' Committee (R. 506, Ex. 37, R. 736-754), including petitioners Milo W. and Reed J. Bekins,<sup>4</sup> is eloquent evidence of the District's critical financial condition and the basic causes underlying its inability to carry the existing bonded debt.

A temporizing plan to extend maturities fifty years with some interest adjustment (R. 506, Ex. 37; R. 749)

1. Per Chief Justice Hughes in *U. S. v. Bekins*, 304 U. S. 27 at 54.

2. Per Justice Cardozo in dissenting opinion in *Ashton v. Cameron County Water Imp. Dist.*, 298 U. S. 513 at 534.

3. See also R. 462, 463, 471.

4. Petition pp. 21-22.

met with indifferent success (R. 497, 499). Later came appropriate legislation and the Reconstruction Finance Corporation<sup>5</sup> offer to refinance at \$515.01 cash for each \$1000 bond (R. 497-8).

The Bondholders Committee submitted this latter plan to the bondholders without recommendation (R. 498). Out of a total of 1200 bondholders 658 voted for it, 141 against (R. 503). In amount \$10,221,000 voted for, \$1,147,000 against (R. 499). By October, 1935, nearly 90% of the bonds had been deposited under the plan (R. 344). Pursuant to contractual arrangements with the District which meticulously provided that the old bonds were to be kept alive until refinancing was complete (R. 343, Ex. 9, Vol. OO, pp. 217-221), the R. F. C. directed the Federal Reserve Bank to purchase the deposited bonds for its account (R. 344, Ex. 10; R. 557). There followed the first trial and confirmation of the plan (R. 343, Vol. OO, p. 222) under the bankruptcy law, subsequently held unconstitutional,<sup>6</sup> thereby resulting in reversal of the judgment.<sup>7</sup> Then came a proceeding under a State act<sup>8</sup> enacted prior to the present Municipal Bankruptcy Composition Act. By March, 1938, the State Court had proceeded so far as to announce a decision on the preliminary features of that proceeding (R. 381) thus laying the legal foundation provided by the State act for condemnation of the dissenting bonds (R. 1028). On April 25, 1938, the Composition Act was upheld as applied to exactly the Merced type of California irri-

5. Referred to throughout this brief as R. F. C.

6. *Ashton v. Cameron County Water Imp. Dist.*, 298 U. S. 513.

7. 89 Fed. (2d) 1002.

8. Irrigation District Refinancing Act, California Stats. 1937, Chap. 24.

gation district<sup>9</sup> and thereupon these proceedings were originated in June, 1938 (R. 8, 36). Again followed a long trial. Every phase of the District's finances, its past and anticipated revenue, including power income (R. 407-8), expenses of maintenance and operation (R. 513) and cost of servicing the proposed R. F. C. refunding bonds (R. 343, Vol. OO, pp. 202, 206) was inquired into and the plan confirmed.

This much can fairly be said: The bonds would have had little value except for the underwriting of the District by the R. F. C. In large measure the value was then already gone. The plan and support accorded by the R. F. C. enabled the bondholders to salvage over 50% of their principal and represented the final culmination of their efforts to protect their investment before all value was destroyed. Petitioners, however, seek 100% primarily upon the theory that the R. F. C. has already refinanced the District, presumably for their benefit, and thereby cut the principal debt structure nearly in half.

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## **ARGUMENT.**

### **I.**

**GRANTING EVERYTHING CLAIMED IN THE PETITION, IT  
SHOULD NEVERTHELESS BE DENIED FOR THE FOLLOWING  
REASONS:**

(a) No conflict among the circuits or the applicable decisions is asserted or exists. There is no showing that the writ is necessary to enable this court to main-

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9. 11 USCA Secs. 401-404; *U. S. v. Bekins*, 304 U. S. 27.

tain uniformity of decision or to exercise a measure of supervisory control. Indeed all rulings on the Municipal Bankruptcy Composition Statute have been singularly consistent.<sup>10</sup>

It is not even claimed that there are "diverse decisions in the District Courts" or cases pending in which action is awaiting authoritative settlement as in *U. S. v. Constantine*, 296 U. S. 287, 290, or that "litigation elsewhere with a resulting conflict of decision" is "improbable" as in *Schriber-Schroth Company v. Cleveland Trust Co.*, 305 U. S. 47, 50.

(b) The petition does not suggest a "grave question of vital importance to the public" (*Southern Pac. Co. v. North Carolina Pub. Serv. Co.*, 263 U. S. 508, 509) or indeed any important question at all. No question of general or local law, no issue of inherent public significance, nothing colorably within the purview of Rule 38 is advanced.

(c) In short, the record evidences only run-of-the-mill litigation and the writ is asked merely to correct

10. 8th Circuit:

*Leuhrmann v. Drainage Dist. No. 7*, 104 F. (2d) 696 (cert. denied 308 U. S. 604).

5th Circuit:

*American Nat. Bank of Nashville v. City of Sanford*, 112 F. (2d) 435 (cert. denied Oct. 14, 1940, 85 L. Ed. Adv. Op. 70);

*Davis v. City of Homestead*, 112 F. (2d) 438 (cert. denied Oct. 14, 1940, 85 L. Ed. Adv. Op. 70);

*Vallette v. City of Vero Beach*, 104 F. (2d) 59 (cert. denied 308 U. S. 586);

*Supreme Forest Woodmen v. City of Belton*, 100 F. (2d) 655;

*Getz v. Edinburg*, 101 F. (2d) 734.

9th Circuit:

See group of cases decided contemporaneously with *Merced* as follows:

*Lindsay-Strathmore Irr. Dist.*, 114 F. (2d) 680;

*Palo Verde Irr. Dist.*, p. 691;

*James Irr. Dist.*, p. 685;

*Corcoran Irr. Dist.*, p. 690; and

*Newport Hts. Irr. Dist.*, p. 563, plan rejected as unfair.



alleged errors arising out of a highly debatable set of facts. The questions relate to particular contracts and involve conflicts of evidence and "turn upon the facts of the particular case".<sup>11</sup> Clearly the writ is designed simply to review the evidence and inferences drawn from it (*General Talking Pictures Corp. v. West Elec. Co.*, 304 U. S. 175, 178)<sup>12</sup> and to give the "defeated party in the Circuit Court of Appeals another hearing" (*Magnum Imp. Co. v. Coty*, 262 U. S. 159, 163).

(d) Furthermore, it does not appear in the petition that petitioners seasonably raised the point which they now urge with greatest emphasis, i. e., that the finding that the plan was "fair, equitable and for the best interest of its creditors" was not a finding of fact.

In the opinion of the Circuit Court there is no such indication. In the District Court in the formal objections made by petitioners to the signing of the findings of fact the proposed finding of fairness is objected to (R. 196) and the claim is made that the evidence fails to sustain it (R. 198), but it is not objected that it is not a finding of fact. A formal request for finding of fact is made by petitioners as follows: "That the plan of composition \* \* \* is (1) unfair (2) inequitable (3) not for the best interests of the District's creditors \* \* \*" (R. 201). In other words, the request is for the exact negative of what the court actually found and what petitioners now assert is a conclusion of law. Finally in some 116 detailed assignments of error (R.

11. See 20 A. B. A. J. 341 per Chief Justice Hughes.

12. See also *National Labor Relations Board v. Waterman Steamship Corp.*, 309 U. S. 206.

283-307) not one charges that the finding of fairness was not a finding of fact or that the court made no finding on fairness, although error is claimed in the finding that the plan is fair for reasons therein set forth.

## II.

**THE PETITION SHOULD ALSO BE DENIED BECAUSE, WITHOUT DISCUSSION OF THE MERITS, OR MORE THAN A CURSORY EXAMINATION OF THE VOLUMINOUS RECORD, THE FOLLOWING SUFFICIENTLY APPEARS:**

(a) The District Court in its formal findings of fact found the plan of composition was "fair, equitable and for the best interests of its creditors" (R. 214). This is a finding of the ultimate fact. And considering the innumerable, diverse and complicated elements which enter into the question of the ability of a public agency to pay its bonds, it is difficult to see how the fact could be better found without writing a treatise.<sup>13</sup>

Doubtless it is a question of law whether the evidence on ability to pay sustains the findings. But that test was met. Moreover the District Court expressly incorporated its opinion or "Conclusions of the Court" into the formal findings (R. 210), and says:

"At the time default occurred in the bonds in 1933 the land of the district as a whole did not and could not be made to pay its cost of operation  
\* \* \*. And according to credible testimony \* \* \*

13. "The capacity of a debtor municipality or taxing district to pay, which is the supposed basis of any fair plan, is at best a matter of very technical estimate based on a great many problematical future variables. Even assuming possession of all the facts as of a certain date bearing on this capacity to pay, there is nevertheless always room for a very wide difference of estimates when that is projected over a future period of years." (Douglas—Democracy & Finance—1940, p. 226.)

the productivity of the land \* \* \* and its revenue is little, if any, better than it was in 1933" (R. 175).

Petitioners say the District Court "rejects" their contention that power revenue is to be taken into account. This is incorrect. What the court said was that the

"\* \* \* experiences of the past, as shown by the record before us, do not warrant a finding that power revenue conditions similar to those existing will continue in the future \* \* \*" (R. 178-9).

Finally the Circuit Court reviewed the case, including the question whether the District could "stand either higher taxes or tolls" (R. 1043); effect of "pyramiding" delinquencies upon "diminishing tax paying acres" (R. 1042); question of insolvency (R. 1055-1056) and ability to pay in general (R. 1058-1060) and made its own finding as follows:

"The testimony \* \* \* amply supports the conclusion that 51.501 cents on the dollar is fair and equitable and all that could reasonably be expected in all the existing circumstances" (R. 1060).

It can now scarcely be questioned that there is a factual determination of fairness.

(b) Failure to find value of District assets (petitioners call them "corporate" assets) was not error. Petitioners have no lien or claim on District assets.<sup>14</sup>

14. In *Peoples State Bank v. Imperial Irr. Dist.* Apr. 16, 1940, 99 Cal. Dec. 317, 101 Pac. (2d) 466 at 469, the California Supreme Court says: "We held, \* \* \* that irrigation districts 'are agencies of the state whose functions are considered exclusively governmental; their property is state owned, held only for governmental purposes; they own no land in the proprietary sense, within the rule of defendant's cases.'"

These consist in the main of reservoir, power plant incident thereto, water rights and canals (R. 424). As is usual with public properties they are capitalized at cost. \$5,500,000 represents the cost of moving a railroad (R. 424)—one reason for default (R. 510). Cost of such assets less depreciation can have only incidental evidentiary bearing on ability to pay. Unless lands produce sufficient revenue to pay costs of operation and maintenance, canals become clogged up, water rights are lost and the system has no going value because there are no paying lands to serve.

(c) Failure to find value of landowners' property was not error. The bondholders' right was mandamus to compel the levy of an assessment as petitioners point out (p. 5). They have no lien on the land (R. 1053).

Moreover, land in an irrigation district which is encumbered by a bond issue in excess of its ability to pay cannot have substantial value. An assessment must be levied each year for the current obligations plus the preceding delinquencies which results in "pyramiding" debts upon diminishing tax paying acres (R. 1042) with the result that in the end nobody can pay and nobody will buy land in or from the District.<sup>15</sup> Even assuming that the bond issue was put upon an "ability to pay" basis, according to the Benedict Report the land would have a value of only \$10,518,307.00 (R. 441, Vol. IV, p. 128).

15. Pyramiding is described in *Provident Land Corp. v. Zumwalt*, 12 Cal. (2d) 365, 85 Pac. (2d) 116 at 118, as follows: " \* \* \* If delinquency occurs a higher assessment may be levied thereafter to make up the loss, and meanwhile the district may proceed to sell the land of the delinquent owner and buy it in. If a heavy delinquency occurs, the remaining land bears a correspondingly heavy burden, for every parcel is liable ultimately for the entire bonded indebtedness, and assessments may therefore be 'pyramided' on the land which is not in default. \* \* \* Moreover, there were no purchasers for the lands taken in by the districts, because a new landowner would immediately become liable for assessments, which could be pyramided to any extent."

(d) That the trial court on the issue of fairness gave some weight to the consents is not error. Even if the consents were incompetent, the question would still remain whether the evidence, exclusive of the incompetent testimony, was sufficient to support the finding.<sup>16</sup> But they were not incompetent. Perhaps by themselves alone they would not establish fairness. But they should be considered with all the other facts. And it is not alone the consents which are important but the whole background of the plan, the processes by which it was negotiated and the methods by which consents were obtained. The record is definite that negotiations were openly, fairly and honestly conducted and the bondholders themselves (not a committee or fiscal agent) with an able, disinterested study of the State University before them, decided the issue by referendum (R. 499) in glaring contrast with the method condemned by this court in *American etc. Life Ins. Co. v. City of Avon Park* decided November 25, 1940. Here there is not a suggestion of coercion, oppression or fraud. And the \$515.01 payment was a net amount to the bondholders. There was no deduction for Committee expense (R. 498).

(e) Petitioners overlook that this proceeding is for composition (we have been unable to find the words "reorganization" or "readjustment" in Chapter IX) and it is composition which is stressed in the decision upholding constitutionality.<sup>17</sup> The difference between "composition" and "reorganization" is also referred

16. See:

*National Ben Franklin Ins. Co. v. Stuckey*, 86 F. (2d) 175, 176;  
*U. S. v. Blumenthal*, 77 F. (2d) 219, 221.

17. *U. S. v. Bekins*, 304 U. S. 27.

to in footnote 14, p. 119, *Case v. Los Angeles Lumber Products Co.*, 308 U. S. 106. Obviously in a public agency there cannot be foreclosure, sale or distribution of assets. "Composition" partakes of the nature of a contract and results "in the main" from voluntary acceptance by the creditors.<sup>18</sup>

In *Leuhrmann v. Drainage Dist. No. 7*, 104 F. (2d) 696 (cert. denied 308 U. S. 604) the court quotes Finding No. 60 (p. 702) that about 97% of the bonds had consented to the plan and that such acceptance was binding upon the minority, and says (p. 703):

"\* \* \* The amount of 25.879 cents on the dollar to be paid on outstanding indebtedness is found, and appears to be, fair and equitable, and 'all that could reasonably be expected under all the existing circumstances.' It appears that some of these bonds had theretofore sold for as little as five cents on the dollar. An overwhelming statutory majority of creditors of all classes have accepted the plan, and, in our judgment, the decree of the district court approving it was right and should be affirmed."

Apparently appreciation in the value of the bonds plus consent was deemed to establish fairness. In the *Merced* case we have both of those elements<sup>19</sup> and much more.

(f) The claim that the State has not cooperated is best answered in the *Bekins* case (*supra*) at page 53, as follows:

18. *Louisville Joint Stock Land Bank v. Radford*, 295 U. S. 555, 585.

19. Merced bonds were as low as 16¢ and 18¢ on the dollar in 1932 before R. F. C. offer (R. 500).

“In the instant case we have cooperation to provide a remedy for a serious condition in which the States alone were unable to afford relief. Improvement districts, such as the petitioner, were in distress. Economic disaster had made it impossible for them to meet their obligations. As the owners of property within the boundaries of the district could not pay adequate assessments, the power of taxation was useless. The creditors of the district were helpless. The natural and reasonable remedy through composition of the debts of the district was not available under state law by reason of the restriction imposed by the Federal Constitution upon the impairment of contracts by state legislation. The bankruptcy power is competent to give relief to debtors in such a plight and if there is any obstacle to its exercise in the case of the districts organized under state law it lies in the right of the State to oppose federal interference.”

(g) The asserted errors respecting the status of the R. F. C. and the payment to that agency of 4% interest are meaningless in the light of the unambiguous provisions of the bankruptcy act and the clear intent of the parties as shown by their contracts. These matters are fully discussed and disposed of by the opinion of the Circuit Court (R. 1032)<sup>20</sup> as are alleged errors relating to *res adjudicata* (R. 1019); pendency of the State proceeding (R. 1027), and other matters.

20. See also *American National Bank v. City of Sanford*, 112 F. (2d) 435 (cert. denied Oct. 14, 1940, 85 L. Ed. Ad. Op. 70) decided after argument in harmony with the decision in the court below respecting sub-section (j) (R. 1036).

**CONCLUSION.**

Because there are (a) no conflicts to harmonize (b) no important questions of law to determine and (c) because none of the alleged errors exist, the petition should be denied.

Dated, Sacramento, California,  
December 9, 1940.

Respectfully submitted,  
STEPHEN W. DOWNEY,  
*Counsel for Respondent.*

C. RAY ROBINSON,  
HUGH K. LANDRAM,  
DOWNEY, BRAND & SEYMOUR,  
*Of Counsel.*





JAN 27 1941

CHARLES ELMORE CROPLEY  
CLERK

# In the Supreme Court

OF THE  
**United States**

OCTOBER TERM, 1940

**No. 591**

PACIFIC NATIONAL BANK OF SAN FRANCISCO  
(a national banking association), et al.,

*Petitioners,*

VS.

MERCED IRRIGATION DISTRICT,

*Respondent.*

## ANSWER TO PETITION FOR A REHEARING.

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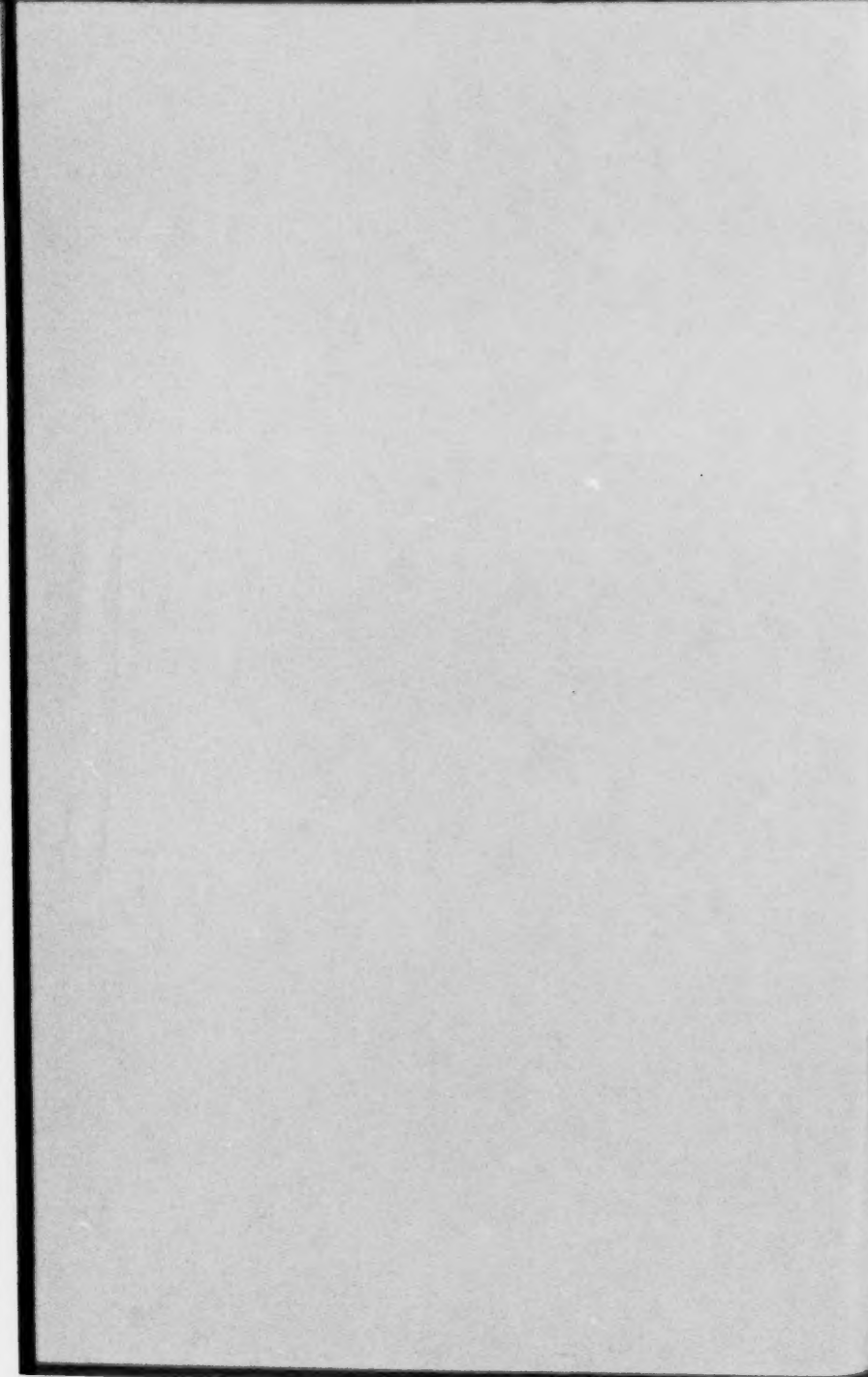
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# In the Supreme Court

OF THE  
**United States**

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PACIFIC NATIONAL BANK OF SAN FRANCISCO  
(a national banking association), et al.,

*Petitioners,*

vs.

MERCED IRRIGATION DISTRICT,

*Respondent.*

---

## ANSWER TO PETITION FOR A REHEARING.

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*To the Honorable Charles Evans Hughes, Chief Justice of the United States, and to the Associate Justices of the Supreme Court of the United States:*

The petition for a rehearing filed herein is not supported by the record on file and is factually inaccurate as to the evidence. It consists of mere vague and general assertions as to what petitioners contend (erroneously) was the evidence.

In refutation of the allegations in the petition, and for reasons why certiorari should not be granted, respondent refers to its brief filed in opposition to the petition for writ of certiorari and respectfully submits that the petition for a rehearing should be denied.

Dated, Sacramento, California,  
January 22, 1941.

STEPHEN W. DOWNEY,  
*Counsel for Respondent.*

C. RAY ROBINSON,  
HUGH K. LANDRAM,  
DOWNEY, BRAND & SEYMOUR,  
*Of Counsel.*



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# In the Supreme Court

OF THE  
United States

OCTOBER TERM, 1940

No. 589 and No. 591

A. A. NEWHOUSE, J. R. MASON and  
MARY E. MORRIS,

*Petitioners,*

No. 589

VS.

CORCORAN IRRIGATION DISTRICT,

*Respondent.*

PACIFIC NATIONAL BANK OF SAN FRANCISCO  
(a national banking association), et al.,

*Petitioners,*

No. 591

VS.

MERCED IRRIGATION DISTRICT,

*Respondent.*

## PETITION FOR A REHEARING.

*To the Honorable Charles Evans Hughes, Chief Justice  
of the United States, and to the Associate Justices  
of the Supreme Court of the United States:*

Comes now petitioner J. R. Mason, owner of bonds  
of respondents, appearing in propria persona and

respectfully presents this, his petition for a rehearing of the petitions for Writs of Certiorari in the above entitled causes.

Your petitioner is a layman who views the practical economic and social consequences of the decision by this Honorable Court with very grave apprehension, for the following reasons:

There is here presented a cause involving democracy and state rights going far beyond the confines of its own facts, and far more fundamental and important than whether your petitioner loses part or all of his investment. The controversy, as petitioner sees it, directly involves both the traditional form and economy of our Government.

Under decisions by the California Supreme Court,\* issued since the *Bekins* case (304 U.S. 27), respondent has been relieved of any possible excuse for seeking to scale down the property rights of petitioner. These late decisions radically alter both the legal character of

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\**Provident Land Corp. v. Zumwalt*, 12 Cal. (2d) 365, 85 P. (2d) 116; *El Camino I. D. v. El Camino Land Co.*, 12 Cal. (2d) 378, 85 P. (2d) 123; *Clough v. Compton-Delevan I. D.*, 12 Cal. (2d) 385, 85 P. (2d) 126; *Moody v. Provident I. D.*, 12 Cal. (2d) 389, 85 P. (2d) 128; *Anderson-Cottonwood I. D. v. Klukkert*, 13 Cal. (2d) 191, 88 P. (2d) 685; *Glenn-Colusa I. D. v. Ohrt*, 31 Cal. App. (2d) 619, 88 P. (2d) 763; *Pac. Coast Jt. Stock Land Bank v. Roberts* (Dec. 1940), 1 Cal. Dec. 467. In *Bekins v. Heiken* (Dec. 7, 1940), 1 Cal. Dec. 258, the same court that issued *Clough v. Baber*, 38 Cal. App. (2d) 50, clarified that opinion, as follows:

"The latest case applicable here is *Clough v. Baber* (supra). There an irrigation district was involved, and the district was admittedly insolvent. The rule is there laid down supported by a long line of well-recognized authorities that when the debtor is insolvent and there are not sufficient funds with which to pay all obligations in full, and the power to raise funds by taxation or otherwise has been exhausted, then equity may order the accessible money prorated among the holders of all valid claims. Such a situation, however, does not here exist. We have no showing of insolvency (and such a status cannot be assumed except upon clear proof), and the power to raise funds by taxation or otherwise has not been exhausted."

the bond contract, and the rights of petitioner, rightly believed to control when the *Bekins* case was decided.

In the light of these late decisions, and under the rule in *C. M. & St. P. & P. R. Co. v. Risty*, 276 U. S. 567, it is necessary to again pass upon the construction of the California Irrigation District Act, as now construed by the highest court of the state.

At the time of the *Bekins* case, petitioners had "the right to enforce their demands solely by an annual assessment on the lands in the district".

The above was said in *Mulcahy v. Baldwin* (1932), 216 Cal. 517, 15 P. (2d) 738 at 741.

Since the *Bekins* case, on November 28, 1938, six California opinions have determined, for the first time that a district organized under the same act as respondent, and all its properties, constitute an indestructible "public trust", and that its properties are not subject to taxation, execution or even to partition, because they all are properties "owned by the state".

But even more crucial, the California court ruled that the full rental value or "usufruct" of all land in the district, or as much of it as might be needed, is permanently a part of this Public Trust, dedicated to "the uses and purposes of the act", among which is the payment of lawfully issued bonds, and interest. (*Provident Land Corp. v. Zumwalt*, supra.)

This presents essentially the same problem for the court to pass upon, as was long before it in the recently announced opinion in *Palmer v. Connecticut Ry.*, No. 38, October Term, decided January 6, 1941,

except that no taxes need be considered in estimating the future rental value of the lands of respondent, and the tenure of respondent district as lessor, under the law is not for a mere 999 years. Surely petitioner is as entitled to "damages" for cancellation of the "lease" owned by respondent, upon which the bonds here involved constitute an equitable mortgage, as other citizens, whose property rights (not secured by the power of taxation) are being guarded?

Under these late cases, *supra*, should the land prove to be without sufficient rental value to meet all costs of operation and also pay the bonds, petitioner's presented bonds would simply never be paid, and he has no cause of action to sue to compel their payment. (*Moody v. Provident*, *supra*.)

Under still later cases (*Anderson-Cottonwood Irrigation District v. Klukkert*, 13 Cal. (2d) 191, 88 P. (2d) 685; *Glenn-Colusa Irrigation District v. Ohrt*, 31 Cal. App. (2d) 619, 88 P. (2d) 763) it was held that because the land and all property, including grain owned or held by a district under the same act as respondent, is property "owned by the state" and impressed with a public trust, it is free and exempt from taxation.

Thus, respondent now has the power and the duty to demand and collect as much of the rental value of all taxable land within its boundaries as it needs to meet its operating expenses, and pay its lawful debts when, as and if due, and funds are available, without any liability for taxes on any of its properties, or risk of execution by any creditor.

Had the highest state court ruled that the lien for general taxes on properties of respondent was senior to the lien of respondent, this court would be, under present rules, wholly lacking in power to impair or destroy the lien for general taxes *for the benefit of* respondent. (*In re Penn. Brewing Co.*, 114 F. (2d) 1010. Petition for Certiorari No. 639 filed December 20, 1940.)

Hence, neither respondent nor petitioner is or can be "caught in a vise from which it is impossible to let them out", as was said in the Ashton (298 U.S. 513) minority opinion.

The law provides facilities for over-extended private lenders holding mortgages and other private liens, junior to the rights of petitioner and respondent, and they ought not by means of any juridicial nicety be allowed to improve their position at the expense of respondent and petitioner.

Chapter IX clearly was never intended to go that far.

The power of Congress to tax the rental value of land, ever since the *Pollock* cases, 157 U. S. 429, 158 U. S. 601, has been subject to the rule of apportionment. Unless this rule could be annulled by and with the consent of one state, does not the rule apply equally when Congress, acting as here, under another clause, seeks to regulate state taxes on the rental value of land which land has been impressed by the state with an indestructible public trust, by untaxing it? Because, regardless of everything, it is obvious that Chapter IX would here relieve no junior creditor or

holder of land, unless the right and duty of respondent to tax that value is curbed in the same proportion as the principal and interest of the bonds are scaled down.

The basic difference between the problems of a private debtor and of respondent, is that no scale down of the property rights of petitioner can in any way increase or lessen the rental value of any land in the district. But a scale down of petitioner's bonds will unquestionably increase the "price", below which no owner will then sell land. The result of denying this petition therefore, must be to take vested rights from petitioner to enable overlapping tax units to again tax lands now owned by respondents, once respondent has parted with its title, and any surplus rental value, after assessments and taxes, would then be appropriated by persons neither legally nor in any other way entitled to it, which unearned income can and will be capitalized in "price" demanded for land by such private interests, from all home and farm seekers. In *Herring v. Modesto Irrigation District*, 95 Fed. 705, 723, is found testimony by an officer of that now rich district, given over 40 years ago, insisting the then outstanding bonds could "never" be paid. Those bonds have since all been paid, and millions more issued, which have always been met on the date due, while the "market" value of the land in that district has also greatly risen.

In *Postal Tel. Co. v. Adams*, 155 U. S. 698, is said:

"The substance, and not the shadow, determines the validity of the exercise of the power."

Chapter IX gives the court no power to administer or control properties of respondent, and there is little or no restraint under state law to prevent respondent permitting the valuable lands it owns from falling into the grip of tax-title sharps, absentee mortgagees, and big landlords, such as have already picked up vast acreages from other "refinanced" districts. This must intensify the problem of the landless and homeless and increase the staggering burdens for relief.

"It is an invitation of the most pronounced kind to covinous transactions, inevitably resulting in the release of property from just burdens of taxation, by a sale thereof, in form only."

*City of Beatrice v. Wright*, 101 N. W. 1041.

It is petitioner's view that such rich irrigated lands be administered as the trust they are, and be made available to home seekers on long term lease direct from the district for the just rental value of the land. The court in *Provident Land Corp. v. Zumwalt*, supra, not only held that respondent can do this, but the implication seems inescapable that as long as respondent is in default, it is its duty to collect the full rent to meet its operating expenses and pay its debts as fast as it can. Obviously, under such a course, no advantage could accrue to any private interest as mere owner, collecting rent from a user of the land.

This view is supported by the unanimous opinion of this court in the *Pollock* cases holding that a tax on ground rent can not be shifted to a user.

Despite the opinion expressed by the highly respected late Justice Oliver Wendell Holmes, as pub-

lished in "Collected Legal Papers" (Harcourt, Brace & Co.) in the chapter headed "Economic Elements", at page 282, as follows:

"Taxes, when thought out in things and results, mean an abstraction of a part of the annual **PRODUCT** for government purposes, and can not mean anything else. Whatever form they take in their imposition they must be borne by the **CONSUMER**, that is, mainly by the working-men and fighting-men of the community. It is well that they should have this fact brought home to them, and not too much disguised by the form in which taxes are imposed." (Emphasis ours.)

it appears that this court did not at all agree with that view in the *Pollock* cases, *supra*, nor does petitioner know of any economist who still even suggests that a tax on the rental value of land can be added to the cost of production, or be shifted to a tenant or to the consumer. (See *Principles of Political Economy*, Book 5, Ch. III, Sec. 2, by John Stuart Mill; *Wealth of Nations*, Book V, Ch. 2, Part 2, Art. 7, by Adam Smith; *Social Statics* (1851), Chap. IX, by Herbert Spencer.)

Unless this petition is granted, the wall keeping speculators away from the many thousands of acres of rich, irrigated land now owned by these and similar districts in this state, will be lowered and the lands will not be administered under the control of this court nor the effective regulation and control of the state itself, as petitioner contends the state can and should do, if the land is to be accessible as sites for homes, orchards and farms for even some of the vast army of landless, homeless and all but destitute families.



There is no reason why these lands can not be and every reason why they should be protected and administered by the state, as the public trust they are, or else acquired by Farm Security Administration, under the Bankhead-Jones Tenant Land Purchase Act, by direct purchase from the district. But, once the composition here sought is approved by this court, this opportunity will vanish. Once these lands are bought up from respondent by mortgagees or speculators, and they get the title, the price demanded will surely be as high as other similar irrigated land is now renting and selling for, outside the taxable boundaries of the districts.

In the Hearings before a sub-committee of the Committee on Education and Labor, U. S. Senate, 76th Congress, 3rd Session, pursuant to S. Res. 266, under "California Agricultural Background" Exhibit 9587, at page 22778, in "Selected large scale farming enterprises in California", Part IV relates to lands held by California Lands, Inc., a subsidiary of Transamerica Corporation, it is reported that the rental value of alfalfa land is \$15-\$20 a year, per acre, and vegetable farms rent at \$15-\$25 an acre. Also that 9/10ths of the lands owned by this company are tenant operated, and the great majority are not former owners.

The Governor's Commission on Re-employment (Calif.) in Chapter VII of its September 30, 1939, Report to the Governor, said:

"Settlement and resettlement programs are largely dependent upon the availability of *low cost lands*, as well as the economical utilization of

tax-delinquent property which has been deeded or sold to the State. \* \* \* A conspicuous feature of agriculture in California is the large scale ownership and operation of farm land. The most casual survey reveals that thousands of families with farm experience *are unable to buy or rent land*. \* \* \* All the problems centering in the ownership and use of land are so vital to the larger aspects of employment and living conditions of our citizens that a thorough overhauling of our land policies, including records, taxes, delinquency laws, penalties and ownership should be made."

The Constitution of California, Art. XVII, Sec. 2 reads as follows:

"The holding of large tracts of land, uncultivated and unimproved by individuals or corporations, is against the public interest, and should be discouraged by all means not inconsistent with the rights of private property".

*Fulton v. Brannan*, 88 Cal. 454.

In more than one district, operating under the same law as respondent, all former mortgages and other private liens were eliminated when the district acquired title "free of all encumbrances", as provided in Section 48 of the Act. But those districts have in no instance collapsed or even ceased their orderly operation because of that. On the contrary, the duty imposed on the district under the law works to free the land from junior and uneconomic private debts, which obviously never could have been paid, unless the assessments and taxes as lawfully due could also be paid. Such lands are now accessible to home seekers,

with whom the district has the same rights to make leases as any private interest has to lease land it owns. (Sec. 47 of the act.)

It is held to be not only the right, but the duty of a county to keep land on its paying tax rolls, and to settle the liens of any other tax unit, which stand in the county's way. (*County of San Diego v. Hammond*, 6 Cal. (2d) 709, 728.) Hence it is clear, that if respondent requires relief, the legislature has provided a method for it to be had from the county. The court may take notice that more than one county in California has issued and sold county bonds to refund bonds of districts, within the county, and which were not issued as county obligations.

From earliest recorded history men have struggled and fought wars for the right to collect rent from irrigated lands. But, under our Constitution this court long ago ruled that if taxes equalled the full rental value of land, even that would involve no impairment of the obligation of contract. (*Providence Bank v. Billings*, 4 Peters 939 at 956 by Chief Justice Marshall.)

Mr. Justice Miller in *Cheatham v. Norvekl*, 92 U. S. 561 said:

"If there existed in the courts, state or national, any general power of impeding or controlling the collection of taxes, or relieving the hardship incident to taxation, the very existence of the government might be placed in the hands of a hostile judiciary."

Congress deleted the words "Political Subdivision" and added a separability clause in its amendment to

the original Chapter IX. Also the omission from the amended act of any provision for state consent, was undoubtedly because in the *Ashton* case it was said: "Neither consent nor submission by the States can enlarge the powers of Congress \* \* \*"

Had the decision of the court under the original Chapter IX been favorable to respondent, Merced Irrigation District, as it was for the *Chicot Co. Dr. District*, instead of the opposite, there is no question but that under the rule announced in *Chicot Co. Dr. Dist. v. Baxter State Bank*, 308 U. S. 371, the bonds held by petitioner would be considered by respondent as void and valueless today. Perhaps because your petitioner is not a member of the bar, rulings that seem contradictory to him, are not so, in law, and for reasons utterly beyond his comprehension.

Petitioner noted with real hope the following statement in the majority opinion, written by Mr. Justice Frankfurter, January 6, 1941:

"A State's interest in the conservation and exploitation of a primary natural resource is not to be achieved through assumption by the Federal courts of powers plainly outside their province and no less plainly beyond their special competence."

*Railroad Comm. of Texas v. Rowan and Nichols Oil Co.*, No. 218, Oct. Term 1940. Decided Jan. 6, 1941.

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#### THE IMPORTANCE OF THE ISSUE.

The legislative and administrative policy of our government and courts, has always been to uphold,

preserve and protect the borrowing and such taxing powers essential to the existence of the state, as the state has delegated to these respondents, inviolate from any interference whatever by the Congress. This is not the first time that states and local governments have gotten into financial difficulties. Had it not been that the courts, and particularly this court set faces of flint against all attempts and schemes to get out of paying, local government self-support and credit would have been weakened, if not destroyed.

With the much heavier tax burdens now facing the people, plus the still heavy mortgage and private debts, it is petitioner's conviction that an enlargement of the bankruptcy power to include the taxing and borrowing power of the states, must prove more an aggravation than a cure, retarding recovery, increasing the danger of inflation and the cost of National Defense.

Because this court so vigorously overruled the argument no doubt seriously advanced by Mr. Geo. H. Maxwell as counsel in the historic *Fallbrook Irr. Dist. v. Bradley*, 164 U. S. 112 case, "It [the act] is communism and confiscation under guise of law"; virtually all the irrigation systems both large and small have since been built in California under this law, with money borrowed from Savings Banks, Insurance Companies, Trustees, etc., through voting and issuing bonds similar to those held by petitioner.

Despite this Fallbrook ruling, which came down after long and piercing argument between the then leading lights in municipal law, including Judge Dillon, and Mr. Choate, the opposition has never ceased in its attempts to get the basic points of law, there settled,

modified or reversed. The proof that this is true, can be found in the almost continuous litigation that has occurred involving this law, and the similar acts of neighboring states, all of which were patterned largely upon the parent California statute. The list of cases is far too long to even attempt to cite, here. Suffice to say, the act has been sustained against every attack, heretofore, and has incalculably benefited the common good and maintained social justice, with equal opportunity for homes and a competence for all willing to work and contribute equitably for the common good. It has, admittedly proven costly and disappointing to those absentees and landlords who had bought up land for speculation.

The area irrigated and irrigable within the 100 California districts is about 4,000,000 acres, which is substantially larger than the acreage served in all the Federal Reclamation Projects in the 17 western states, combined. The market value of the land in these California districts, prior to the depression was officially estimated at more than \$1,000,000,000., while the total amount of bonds issued never reached 10% of that figure. This record constitutes a saga of democratic and vital self-government, which because of the power and duty to tax land values has never asked nor received in over 50 years, one dollar of subsidy from any other public treasury.

The court may take judicial notice, at this point, that since 1933 the Legislature of California, has "relieved" local school and road districts, which together with their bond holders were facing difficulties equal if not greater than those of respondents and your

petitioner, by the enactment of sales taxes and gas taxes, allotting sufficient amounts thereof back to those local districts to make up any deficit. Obviously this has operated to lessen the tax on land values, which those districts, lacking such allotments from the state, would have had to levy and collect. The state, in turn, during the same years has gotten more and more money from the Congress, all of which has tended to shift the costs of government from land holders, as such, on to the backs of labor and capital. Petitioner views with alarm, this trend.

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#### SUMMARIZING.

The bonds of your petitioner, which are about to die, are not merely secured like general obligation county and city bonds, but under decisions of the California Supreme Court, given after the *Bekins* case, and after the majority of original bondholders parted with all rights, at a price they believed they had to accept, under threats of "bankruptcy", or other reasons, it was ruled that respondents and all their property is "owned by the State", and is indestructibly dedicated to a "Public Trust", including the full rental value of all land, present and future, until every bond is paid, regardless of how long that may take.

At the time respondents executed the bond contract with petitioner, there was nothing in the law permitting the State to "consent" with any authority to repudiate or destroy this Public Trust.

The bonds are wholly exempt from Federal Income Tax. (72 Op. A. G. 38, Feb. 4, 1937.) They are not

callable prior to maturity at any figure, and promise payment in gold coin. Unlike corporate bonds, they possess no acceleration or foreclosure clause.

The bonds of respondents were issued under supervision and control of the California Districts Securities Commission, composed of the Attorney General, Superintendent of Banks and State Engineer, and pursuant to their approval, are endorsed by the State Controller, evidenced by an unqualified certificate impressed on each bond.

The bonds held by petitioner in this case are so certified and are still a lawful investment for savings banks, insurance companies, trustees and for any funds that may be invested in this state in the bonds of any state, county or city. They are also eligible to secure deposits of public funds.

It is not clear what will be the effect on this certification of the bonds, should this petition not be granted.

In no way does one bond constitute a lien on respondent's property, ahead of the others, except as due and presented for payment.

The Congress authorized the R.F.C. to loan money to respondent when a majority of the original creditors were willing to accept the scale down figure set by the R.F.C. Congress did not make it a requisite that consent be unanimous, for it was known that some would not need or wish to sell. Surely had even all the holders, save petitioner, elected to give their bonds away, petitioner would not be bound by such action alone, whether under the bankruptcy or



any other clause. He is not only willing but is in full support of any orderly course that will uphold the rights of every other bond holder, in strict fulfillment of the contract each holds. It is a fundamental principle of bankruptcy that "equality between creditors is necessarily the ultimate aim of the bankruptcy law, and to obtain it we must regard the essential nature of transactions, not their forms".

*Clarke v. Rogers*, 228 U. S. 533, 57 L. ed. 953.

In his essay on Liberty, John Stuart Mill contributed one of the noblest interpretations of democracy ever written.

Denying "the right of the people to exercise coercion, either by themselves or by their government", he declares that the protection of minority opinion and rights is the only safe and true basis for a free people. "If all mankind minus one were of one opinion", says Mill in a famous passage, "and only one person were of the contrary opinion, mankind would be no more justified in silencing that one person, than he, if he had the power, would be justified in silencing mankind. \* \* \* All silencing (of opinion)", he continues, "is an assumption of infallibility" and therefore a blow at the very heart of democracy.

Petitioner seeks no advantage, and has the utmost confidence that this Honorable Court will not be a party to the denial of minority rights, here present.

Respondents, whether with or without the connivance of mortgagees and the state, should not now be permitted to permanently impair if not wreck the vitality

and effectiveness of this venerable law, with such a record of achievement for the common good behind it, and with so much that can and still needs to be done under it, in the future.

No question is here raised over the constitutionality of the amended Chapter IX. But, in the light of the "Public Trust" created in late decisions by the highest State court, after the *Bekins* case and discussed supra and in briefs of other petitioners in this and related petitions recently submitted, it is certain that if there is any kind of governmental instrumentality, political subdivision or taxing authority of a state, whose tax-secured bonds are immune and exempt from the application of this act under the separability clause, the bonds of petitioner are also entitled to immunity.

The national importance of the cause plus the new necessity for statutory construction and clarification, clearly justify this earnest appeal for a review, and prayer that Writs of Certiorari issue out of and under the seal of this Honorable Court, as prayed for in the petitions for Writ of Certiorari herein.

Dated, San Francisco, California,

January 24, 1941.

Respectfully submitted,

J. R. MASON,

*In Propria Persona.*

## CERTIFICATE OF PETITIONER.

I hereby declare that the foregoing Petition for a Rehearing is submitted in good faith and is not interposed for delay.

Dated, San Francisco, California,  
January 24, 1941.

J. R. MASON,  
*In Propria Persona.*